CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 128

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 9, 1937
CERTIORARI GRANTED OCTOBER 11, 1937]

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DOCKET ENTRIES.

JOHN H. THERRELL, also known as
J. H. THERRELL,
Petitioner,

versus Docket No. 78961.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Appearances.

For Taxpayer:
H. M. Hampton, Esq.

For Comm'r.:
C. A. Ray, Esq.

1935.
Apr. 3—Petition received and filed. Taxpayer notified. (Fee paid.)
Apr. 3—Copy of petition served on General Counsel.
May 7—Answer filed by General Counsel.
May 11—Copy of answer served on taxpayer.
June 8—Motion for circuit hearing at Florida filed by taxpayer. 6/10/35 granted.
Dec. 17—Hearing set week of Feb. 24, 1936, at Jacksonville, Florida.

1936.
Feb. 24—Hearing had before Mr. Smith on merits. Submitted. Petitioner's brief due 3/23/36—respondent's brief due 4/8/36—petitioner's reply 4/23/36.
Mar. 19—Transcript of hearing of Feb. 24, 1936, filed.
Mar. 23—Brief filed by taxpayer. 3/23/36 copy served.
May 21—Memorandum opinion rendered, Charles P. Smith, Div. 5. Judgment will be entered for the respondent.

May 21—Decision entered, Charles P. Smith, Div. 5.
July 13—Petition for review by U. S. Circuit Court of Appeals (5) with assignments of error filed by taxpayer.
July 13—Statement of evidence lodged.
July 20—Proof of service of petition for review filed.
July 20—Proof of service of statement and setting for hearing on July 30, 1936, filed.
July 20—Praecipe with proof of service thereon filed.
July 21—Objections to statement of evidence filed by General Counsel.
July 22—Notice of change of hearing to July 29, 1936.
July 27—Proof of service of objections filed by General Counsel.
July 29—Hearing had before Mr. McMahon on approval of statement of evidence. Record made and referred to Mr. Smith.
July 30—Order that petitioner's request for an approval of the statement of evidence lodged is hereby denied, entered.

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2 PETITION.

Filed April 3, 1935.

United States Board of Tax Appeals.

John H. Therrell, also known as J. H. Therrell,
Petitioner,
vs. Docket No. 78961.
Commissioner of Internal Revenue, Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of

deficiency IT:AR:C-1 CGW-90D, dated February 14, 1935, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual residing at 503 Wenona Street in the City of Ocala, State of Florida, is a natural born citizen of the United States of America, and a citizen and resident of the State of Florida.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to petitioner on February 14, 1935.

3. The taxes in controversy are income taxes for the calendar year 1931 for $108.78, and for the calendar year 1932 for $6333.63, total $6442.41, less amount assessed in 1932 of $4.10, leaving amount of deficiency $6438.31.

4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors,—

a. That the Commissioner in determining the liability of petitioner for such tax, erred in holding and determining that the compensation or commission paid petitioner as Liquidator of the Bank of Bay Biscayne, a banking corporation, of Miami, Florida, was taxable income.

b. That the Commissioner in determining the liability of petitioner for such tax, erred in holding and determining that the compensation or commission paid petitioner as Liquidator of the Biscayne Trust Company, a banking corporation, of Miami, Florida, was taxable income.

c. That the Commissioner in determining liability of petitioner for such tax, erred in

holding and determining that the compensation or commission paid petitioner as Liquidator of the Guardian Trust Company, a banking corporation, of Miami, Florida, was taxable income.

d.. That the Commissioner in determining liability of petitioner for such tax, erred in holding and determining that the compensation or commission paid petitioner as Liquidator of the Trust Company of Florida, a banking corporation, of Miami, Florida, was taxable income.

e. That the Commissioner in determining liability of petitioner for tax in said years of 1931 and 1932, erred in finding and holding that the sums of money paid petitioner as Liquidator for the several institutions mentioned in assignments a, b, c and d respectively, was taxable income.

f. That the Commissioner in determining liability of petitioner for tax in said years 1931 and 1932, erred in not finding and holding that the sums of money paid petitioner as liquidator for the several institutions mentioned in assignments a, b, c and d respectively, was for money paid petitioner as an employee or officer of the State of Florida, and therefore not taxable.

5 g. That the basis of said findings of the Commissioner is the opinion of General Counsel, Memorandum 13488, stating it as his opinion that the appointment of a Liquidator or Receiver of Banks under the State Law, constituted such Liquidator an independent contractor, as distinguished from an employee, or officer, but the said decision was and is erroneous, because in direct conflict with the laws of the United States, and of the decisions of the final Appellate Courts of the United States, construing such laws.

h. That the findings and determination of tax liability of petitioner is contrary to law.

i. That the finding and determination of tax liability of petitioner is in conflict with the judicial determination of the matters passed upon, as determined by the United States Courts.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

a. The several assessments being based upon the identical state of affairs and arising under the same circumstances and conditions in each case, depends for their validity upon the same acts, to-wit: whether or not the said items are taxable as income, each and every of the same having been received by petitioner while acting as an employee or officer of the State of Florida, to-wit: as Liquidator appointed pur-
6 suant to the Laws of Florida of bank and trust companies in liquidation, that is to say,— petitioner admits receiving each of the said items in each of the said years, making the aggregate attempted to be assessed as deficiency for said years, but claims that said items are not taxable, but were and are exempt from taxation because he was,—

(1) Appointed by the Comptroller of the State of Florida on the 22nd day of July, 1930, to be the Liquidator of the Bank of Bay Biscayne, a State banking corporation doing business in Miami, Florida, and a part of the alleged income for each of said years was paid to him as compensation for his services to the State of Florida as Liquidator for said institution.

(2) Appointed by the Comptroller of the State of Florida on the 27th day of March, 1931, to be the Liquidator of the Biscayne Trust Company, a trust company doing business in Miami, Florida, and a part

of the alleged income for said years was paid to him as compensation for his services to the State of Florida as Liquidator for said institution.

7 (3) Appointed by the Comptroller of the State of Florida on the 9th day of May, 1931, to be the Liquidator of the Guardian Trust Company, a trust company doing business in Miami, Florida, and a part of the alleged income for each of said years was paid to him as compensation for his services to the State of Florida as Liquidator for said institution.

(4) Appointed by the Comptroller of the State of Florida on the 27th day of November, 1931, to be the Liquidator of the Trust Company of Florida, a trust company doing business in Miami, Florida, and a part of the alleged income for each of said years was paid to him as compensation for his services to the State of Florida as Liquidator for said institution.

8 b. The Comptroller of the State of Florida is a Constitutional officer of said State and is authorized by the Statute aforesaid, Section 19 of Chapter 13576, Laws of Florida, to make appointment of Liquidators of insolvent banks and trust companies, and is authorized by Section 21 thereof, to fix their compensation within certain limits; and such appointment being made and confirmed by the Court constituted the petitioner either an officer or employee of the State of Florida within the meaning of Section 213 of the Income Tax Law, under which said assessment is attempted to be made, being Section 954, U. S. C. A. and as is also provided for in Section 507 of the Revenue Act of 1928, now Section 1065-b U. S. C. A.

9 c. A copy of the respective appointments of the petitioner as Liquidator for the several institutions aforesaid, with a copy of the order of confirmation thereof, are hereto attached marked re-

spectively, Exhibits B, C, D and E, and the same are made a part hereof.

d. That during the entire period of his employment which began the 22nd day of July, 1930, and ending December 31, 1932, petitioner was continuously under the direction and control of the Comptroller of the State of Florida and subject at all times to his orders and directions, and that during said time he transacted no other business of importance, but gave his entire time to the performance of the duties cast upon him under the appointment by the Comptroller aforesaid, which appointment he accepted as above stated and performed the duties thereof cast upon him by virtue of his appointment by the Comptroller under the provisions of the statute aforesaid.

e. That the moneys received from the several trust companies and bank aforesaid by the petitioner as Liquidator of said several institutions, and now sought to be taxed as additional income, were paid by warrants drawn by the State Comptroller on the Treasurer of the State of Florida, and constituted payments by the State of Florida for said services.

f. Banking is an essential function of the State Government, said banks and trust companies being created and controlled by and through the State, and the Comptroller of the State has supervision and control over each and every bank; and all of said banks and trust companies are subject to the orders and directions of the Comptroller, and the liquidation of said banks is purely a state function and cannot be interfered with by Courts, either State of Federal. All of the funds arising from such liquidation are paid into the State Treasury, pursuant to statute laws of Florida, so that all banks and trust companies are essentially a part of the State Government and any payments

made for the services of a Liquidator are based upon state law, and the office of Liquidator after being once established has tenure, in that it continues either until such time as such bank or trust company is liquidated and wound up, or until its capital is repaired, its solvency established and its properties and effects returned to its stockholders; and during the time of such administration neither the stockholders nor officers of such corporation have any control, management, discretion or right in regard to its affairs, but all of said matters are administered strictly through the office of the Comptroller of the State of Florida, pursuant to the laws of said State.

g. That the basis upon which the said finding and determination of the deficiency set forth by the Commissioner of International Revenue in his notice of deficiency dated February 14, 1935, is erroneous and without legal basis, because the facts clearly established show that this petitioner was in fact an employee or officer of the State of Florida, duly appointed to such position by the Comptroller of the State of Florida, as authorized and provided for by the Statute laws of Florida; that by the said law the office of Liquidator is authorized and provided for, and upon the happening of the events mentioned in said Statute law, it becomes the duty of the Comptroller of the State of Florida to take possession of such institution, and to appoint some person to take charge of and administer the affairs of such institution; that such Liquidator is vested with the title to all of the assets of such institution, and may sue for and collect the debts of such institution including the liability of the stockholders as fixed by law; that it is only because such law creates and constitutes a liquidator of banks as an officer or agent of the State, or employee or agent of a State office, that the title to the effect of such institution, in liquidation, becomes so vested, because of which such statute in no

manner authorizes or creates the relation of a mere contractor, but provides for and contemplates continuity of service, subject to the direction of the Comptroller.

13 h. Petitioner further shows that there was a direct connection between the Bank of Bay Biscayne and the Biscayne Trust Company and the Guardian Trust Company in this,—that the Biscayne Trust Company was an affiliate organization or subsidiary of the Bank of Bay Biscayne, being owned by practically the same stockholders and in the greater part operated by the same officers and directors as the Bank of Bay Biscayne. That upon said institution becoming insolvent which took place a short time after the Bank of Bay Biscayne became insolvent, certain persons believing that they could work out the affairs of the Biscayne Trust Company, organized the Guardian Trust Company, and said Guardian Trust Company was appointed liquidator for said purpose. That later the said Guardian Trust Company also became affiliated with the City Trust Company, and having become involved in litigation with certain creditors of the said City Trust Company, it became impractical for said concern to go forward with its purpose; whereupon it was removed as liquidator, and petitioner was appointed in its place. That during the time of the liquidation in the hands of the Guardian Trust Company it had taken over certain trusts and properties in which the Bank of Bay Biscayne and the

14 Biscayne Trust Company were interested, and the greater part of the assets of said Guardian Trust Company consisted of properties taken over through this medium, but it still remained in liquidation and uncompleted. That said Guardian Trust Company shortly thereafter having become involved financially, and it having become necessary to appoint a liquidator under the laws of Florida, because of these relationships which grew out of said transactions, peti-

tioner was appointed as the liquidator of said Guardian Trust Company. That all of these matters centering around the affairs of the Bank of Bay Biscayne, and the Guardian Trust Company having become incapable of performing the trust for which it was organized, the same having been intended to be a mutual relationship between that and the liquidator of the Bank of Bay Biscayne, it was essential that the person liquidating and in charge of the liquidation of said Bank of Bay Biscayne be made the liquidator of said institutions, the Biscayne Trust Company and the Guardian Trust Company.

15 That the said Biscayne Trust Company at the inception of its liquidation, and it and the Guardian Trust Company at the time of the appointment of petitioner held a large number of hotels, apartment houses and business property which were being administered under the said trust, and the Bank of Bay Biscayne before its insolvency, had made advances and loans to a large number of said properties, so that there was owing to the Bank of Bay Biscayne large sums of money which it became necessary to follow through these trust companies, and the Bank of Bay Biscayne was also indebted to said Biscayne Trust Company. Because of which it was a matter of economy and of expediency to continue the relationships of these concerns through the same organization.

That the Trust Company of Florida which was generally known as a G. L. Miller organization, had no direct relationship with the Biscayne Trust Company, Bank of Bay Biscayne or the Guardian Trust Company, but had financed and was either indebted to or was handling a large number of properties such as hotels, apartment houses and business houses in the City of Miami. That the City of Miami had gone through and was going through at this time a

16 very hectic condition with reference to deflation in property values. That the said Trust

Company of Florida represented approximately 250 properties, all of which had been theretofore rented and handled through the said Trust Company of Florida. That the said Trust Company of Florida having become insolvent after the Biscayne Trust Company had become involved, and after this petitioner as Liquidator aforesaid, had reorganized the business of the Biscayne Trust Company and had begun to get the properties into producing shape, it was a matter of grave concern to appoint an outside third party to liquidate said institution and thereby permit the Liquidator of that institution to go into competition with the Liquidator of the trust compannies above mentioned, because if the property of the Trust Company of Florida was thrown on the market as distress property, it would produce such a result that all the properties of the Biscayne Trust Company would be jeopardized.

17 In addition to this the Trust Company of Florida was wholly without funds, and unless some arrangement could be made to operate its affairs cheaply and under some other organization, its properties probably would have been sacrificed and the creditors of said institution would have suffered untold loss; so that it was necessary in the liquidation of all of these matters that one central organization be set up so as to reduce the expense of operation and to operate said institution in connection with the above mentioned trusts of the Bank of Bay Biscayne, the Biscayne Trust Company and the Guardian Trust Company; for which reason this petitioner was appointed Liquidator of said Trust Company of Florida which had gone through at that time considerable litigation both in the State and Federal Courts with respect to the rights of the State or the Federal Government over it. That the greater part of the properties under said several trusts was in Miami and the vicinity of Miami, and under the said arrangement, although this petitioner held separate appointments of the

several trust companies aforesaid from that of the Bank of Bay Biscayne, all of the same were administered principally through the same clerical help and under the same supervision as a matter of
18 economy, and to prevent the sacrifice of the several properties for the reasons herein set forth.

That in addition to these reasons it was the practice of the Comptroller of the State of Florida to consolidate as far as possible the liquidation of different institutions so that the same clerical force with small exceptions, could be used for the administration of such several institutions. That the Trust Company of Florida had a large amount of property, but its business was of such a nature that very little revenue was then being produced for said company, and said company was hopelessly insolvent; so that at that time there was but little reason to believe there would be sufficient income from its properties immediately to set up a separate organization for liquidation. That an attempt had been made to take over the
19 same through the Federal Court, and a Federal Court Receiver had been appointed for a large number of its properties, but on appeal from that order the Circuit Court of Appeals reversed the District Court, and by the time the same was heard its business was in a chaotic condition, and it was essential that the same be thrown into some other liquidation to save expenses of a separate organization.

For all of these reasons the several institutions were administered by, through and under the supervision of this petitioner under the several appointments aforesaid so made by the Comptroller of the State of Florida.

20 i. Petitioner further says that in accordance with the several appointments hereinabove recited and referred to as Liquidator for the

several institutions aforesaid, he duly accepted each and every of said appointments, and in pursuance thereof did execute bond with surety payable to the Governor of Florida and his successors in office as provided by law, and did then and thereby become obligated as an official of the State of Florida and required to account to the State of Florida for all of his acts and doings as Liquidator of the several institutions aforesaid; and that as such Liquidator he did collect and receive moneys and property, and did turn over and deliver the said moneys so received to the State Treasurer of the State of Florida as required by law, and did account to the State of Florida and to the Comptroller of the State of Florida, as well as the Treasurer of the State of Florida, for all acts done and performed by him as Liquidator aforesaid.

21 j. And petitioner says that the effect of the several appointments by the Comptroller of the State of Florida, and approved by the Courts having jurisdiction over the same, constituted petitioner an officer or employee of the State of Florida, so that the compensation paid to him for his services as Liquidator for the several institutions was paid to him as an officer or employee of the State of Florida, and that there is no authority in law to tax compensation paid to an employee of the State of Florida, but such compensation is exempt from taxation by the United States of America.

22 Wherefore, petitioner prays that this Board may hear the proceedings and re-determine the liability of petitioner for the said deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency above mentioned, and will overrule, set aside and vacate the said findings, and decree and determine that the moneys so paid to petitioner as hereinabove set forth, be exempt to him and not subject to income tax as is found by the Commissioner

of Internal Revenue in the notice of deficiency aforesaid.

H. M. HAMPTON,
Counsel for Petitioner.

P. O. Box 830,
Ocala, Florida.

23 State of Florida,
County of Marion, ss.

John H. Therrell, also known as J. H. Therrell, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

JOHN H. THERRELL.

Subscribed and sworn to before me, this 25th day of March, 1935.

(Notarial Seal)

MIRIAM BRIDGES,
Notary Public, State of Florida at Large. My Commission expires Dec. 30, 1936.

24 EXHIBIT "A".

IT:AR:C-1 CGW-90D.

Feb. 14, 1935.

Mr. J. H. Therrell,
503 Wenona Street,
Ocala, Florida.

Sir:

You are advised that the determination of your income tax liability for the year(s) 1931 and 1932 dis-

closes a deficiency of $6,438.31 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1928 and section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING,
Commissioner.
(Signed) By CHAS. T. RUSSELL,
Deputy Commissioner.

Enclosures:
Statement
Form 870.
CGW/HB-3.

25 STATEMENT.

IT:AR:C-1.
CGW-90D.

In re: Mr. J. H. Therrell,
503 Wenona Street,
Ocala, Florida.

Income Tax Liability.

Years	Income Tax Liability	Income Tax Assessed	Deficiency
1931	$ 108.78	None	$ 108.78
1932	6,333.63	$4.10	6,329.53
Totals	$6,442.41	$4.10	$6,438.31

Reference is made to Bureau letter dated January 15, 1935, advising you of the approval of the report submitted by the Internal Revenue Agent in charge at Jacksonville, Florida, a copy of which was transmitted to you under date of August 21, 1934. The records of the Bureau do not indicate that a reply has been received to that letter.

Careful consideration has been accorded your protest dated September 13, 1934, in connection with the findings of the examining officer, and the information submitted at conferences held in the office of the internal revenue agent in charge.

With respect to the question of whether or not the compensation received by you as liquidator for Florida State banks is subject to tax, your attention is invited to General Counsel's Memorandum 13488 published in Internal Revenue Bulletin XIII-35, page 9, in which it was held that the compensation of a taxpayer appointed by the state comptroller of Florida as liquidator of each bank liquidated is subject to federal in-

come tax. The action of the revenue agent in considering such income received by you as taxable is accordingly sustained.

Recomputation of Tax.

1931.

Net income shown on the return	$ 1,530.97
Plus: 1. Fees as bank liquidator	8,555.61
Total	$10,086.58
Less: 2. Error in addition on the return	.17
Adjusted net income	$10,086.41
Less: Personal exemption	3,500.00
Income subject to normal tax	$6,586.41
Tax at 1½% on $4,000.00	$ 60.00
Tax at 3% on $2,586.41	77.59
Surtax on $10,086.41	.86
Total tax	$ 138.45
Less: Credit for earned income	29.67
Net tax assessable	$ 108.78
Tax assessed	None
Deficiency	$ 108.78

Explanation of Changes.

1. Information on file discloses that you received fees totaling $8,555.61 as a bank liquidator, which amount was not reported as income. Your net income has been adjusted accordingly.

2. It is noted that the total of lines 13 to 18 on the return is $3,579.43 instead of $3,579.26. This adjustment reduces the net income by $.17.

Computation of Credit for Earned Income.

Earned net income	$9,455.61
Less: Personal exemption	3,500.00
Balance	$5,955.61
Tax at 1½% on $4,000.00	$ 60.00
Tax at 3% on $1,955.61	58.67
Total	$ 118.67
25% credit	$ 29.67

1932.

Net income shown on the return	$ 2,602.43
Plus: Fees as bank liquidator	39,448.07
Adjusted net income	$42,050.50
Less: Personal exemption	2,500.00
Income subject to normal tax	$39,550.50
Tax at 4% on $4,000.00	$ 160.00
Tax at 8% on $35,550.50	2,844.04
Surtax on $42,050.50	3,329.59
Net tax assessable	$ 6,333.63
Tax assessed	4.10
Deficiency	$ 6,329.53

Explanation of Changes.

Information on file, discloses that you received fees totaling $39,448.07 as a bank liquidator, which amount was not reported as income. Your net income has been adjusted accordingly.

A copy of this letter has been mailed to your representative, Mr. H. M. Hampton, Postoffice Box 830, Ocala, Florida, in accordance with the authority conferred upon him in the power of attorney executed by you and on file with the Bureau.

CGW/HB-3.

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28 EXHIBIT "B".

APPOINTMENT OF LIQUIDATOR.

Clerk's File F 20197.

Dated .....

Filed July 29, 1930.

Recorded in Deed Book 1395, page 1.

Comptroller's Office, State of Florida.

In Re: The Liquidation of Bank of Bay Biscayne, a corporation doing a banking business at Miami, Florida. File No. 13278-C.

Having become satisfied from the report of State Bank Examiner that the Bank of Bay Biscayne, a corporation duly chartered and authorized to do a banking business under the laws of the State of Florida at Miami, has become insolvent and is in default, I do hereby appoint J. H. Therrell as Liquidator of the said Bank of Bay Biscayne doing business at Miami, in the County of Dade, State of Florida, with all the usual powers and duties of a Liquidator by virtue of Section 19, Chapter 13576, Laws of Florida, for the purpose of closing out and winding up the affairs of the said Bank of Bay Biscayne upon the said J. H. Ther-

rell, executing and filing a bond in the usual form payable to Doyle E. Carlton, Governor of the State of Florida, and his successors in office in the penal sum of $50,000.00 to be approved by the Comptroller, as provided by law and the said Bank of Bay Biscayne being hereby directed to forthwith deliver all of its property of any nature whatsoever, real and personal, things in action, moneys, books, debts, legal and equitable and all property and effects of any nature and description whatsoever of said bank to the said Liquidator and the said Liquidator is hereby authorized and directed to be governed in all his acts and doings relative to said property by the laws of the State of Florida, and the ratification of the Comptroller and the orders of the Court, the said Liquidator being especially authorized to take immediate charge of said property of said bank upon the approval of the bond herein mentioned, and to proceed at once to collection of all amounts due to the said Bank of Bay Biscayne of Miami, Florida.

In testimony whereof, I have hereunto set my hand and official seal at the Capitol, Tallahassee, Florida, this July 21, 1930.

(Signed) ERNEST AMOS,
Comptroller State of Florida.

(Comptroller's Seal).

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29 To the Honorable Judge of the Circuit Court of the Eleventh Judicial Circuit State of Florida:

It appearing by the report of a State Bank Examiner that the Bank of Bay Biscayne of Miami was insolvent and unable to meet its liabilities, I did on July 21, 1930, appoint J. H. Therrell as Liquidator of said bank in pursuance of the provisions of Section 19 of Chapter

13576, Laws of Florida, a copy of said appointments being herewith attached; and did on July 21, 1930, address to James H. Gilman, President of the Bank of Bay Biscayne the following notice:

Mr. James H. Gilman, President,
Bank of Bay Biscayne,
Miami, Fla.

Dear Sir:

I did on July 21, 1930, appoint J. H. Therrell, as Liquidator of the Bank of Bay Biscayne of Miami, Florida, acting under and in pursuance of the provisions of Section 19, of Chapter 13576, Laws of Florida; and you are hereby notified that on July 28, 1930, or as soon thereafter as the same may be heard, I will apply to the Honorable ..... Judge of the Eleventh Judicial Circuit Court of Florida at Miami, Florida, for an order confirming my action in ascertaining that the Bank of Bay Biscayne of Miami, Florida, was and is insolvent and in appointing J. H. Therrell as Liquidator thereof.

Yours very truly,
(Signed) ERNEST AMOS,
Comptroller, State of Florida.

Appended hereto is the following petition:

I respectfully petition and apply to your Honor for a confirmation of my action in appointing J. H. Therrell as Liquidator of the Bank of Bay Biscayne, a corporation doing a banking business at Miami, Florida, and submit the attached affidavit of State Bank Examiner Geo. C. White, setting forth that at the time the said appointment was made, the said Bank of Bay Biscayne of Miami, Florida, was insolvent and in default and assuring Your Honor that should any other or further evidence be deemed necessary by you I am ready to comply with any request that you may make in the premises.

(Signed) ERNEST AMOS,
Comptroller, State of Florida.

Appended hereto is the following affidavit:

State of Florida,
County of Dade.

Before the undersigned a Notary Public in and for the State of Florida at Large, personally appeared Geo. C. White, who being first duly sworn says: that he is a State Bank Examiner and as such is the agent of the Comptroller of the State of Florida; in pursuance to instructions given him by the said Comptroller, he did make an examination of the Bank of Bay Biscayne of Miami, Florida, doing a banking business at said place, and that from said examination, according to his own knowledge in part and upon information and belief as to the remainder, the said affiant believes that the Bank of Bay Biscayne of Miami, Florida, is insolvent and unable to meet its obligations, and is now closed and in the hands of the Comptroller of the State of Florida.

(Signed) GEO. C. WHITE,
State Bank Examiner.

Sworn to and subscribed before me this June 14, 1930.

(Signed) EILEEN E. GRAHAM,
Notary Public State of Florida at Large. My Commission expires June 28, 1930.

(Notary Public Seal).

Appended hereto is the following Affidavit:

State of Florida,
County of Dade.

Before the subscriber, an officer authorized to administer oaths under the laws of the State of Florida, personally appeared James H. Gilman, who being duly sworn deposes and says: that he is the President of the Bank of Bay Biscayne of Miami, Florida, a corporation duly chartered and existing under the laws of the

State of Florida, to do a banking business and that on behalf of said bank he accepts service of notice of the Comptroller and waives further consideration in the matter of the appointment of J. H. Therrell, as Liquidator of the Bank of Bay Biscayne of Miami, Florida.

(Signed) JAMES H. GILMAN,
President.

Sworn to and subscribed before me this July 22, 1930.

(Signed) M. E. DENTON,
(N. P. Seal) Notary Public for the State of Florida at Large. My Commission expires December 6, 1932.

Note: This instrument filed July 26, 1930, and recorded in Circuit Court Minutes No. 52, Page 64, Public Records Dade County, Florida.

ORDER CONFIRMING APPOINTMENT OF LIQUIDATOR.

31 Clerk's File F 20202.

Dated .....

Filed July 29, 1930.

Recorded in Deed Book 1395 page 10.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Flordia, in Chancery No. 13278-C.

Ernest Amos, Comptroller, State of Florida,
vs.
Bank of Bay Biscayne, Miami, Florida.

This cause coming on to be heard upon petition of Ernest Amos, Comptroller, of the State of Florida, for an order confirming the appointment of a liquidator for the Bank of Bay Biscayne of Miami, Florida, by the said Comptroller, and it appearing by evidence sub-

mitted that the said corporation is insolvent and that the president of said bank has waived further consideration and consented to the immediate appointment of a liquidator as aforesaid, and the Court being fully advised in the premises;

It is thereupon ordered, adjudged and decreed that the appointment of a liquidator for the said Bank of Bay Biscayne of Miami, Florida, by the Comptroller of the State, is hereby approved and confirmed, and the said Liquidator is hereby vested with all the powers conferred upon receivers or liquidators for banks, under the laws of the State of Florida, subject to the restrictions contained in such laws.

Done and ordered at Chambers at Fort Lauderdale, Florida, this July 25, 1930.

(Signed) GEO. W. TEDDER,
Circuit Judge Pro haec vice.

This instrument was filed for record July 26, 1930 and recorded in Circuit Court Minute Book 52 page 59, Public Records of Dade County, Florida.

CERTIFICATE OF QUALIFICATION OF LIQUIDATOR.

32 Clerk's File G 15287.

Filed July 27, 1931.

Recorded in Deed Book 1450 page 25.

In the Circuit Court of the Eleventh Judicial Circuit of Florida in and for Dade County, at Law No. 13278.

In the Matter of:
Liquidation of the Bank of Bay Biscayne.

This is to certify that I, Ernest Amos, Comptroller, of the State of Florida, acting under and in pursuance

of the authority vested in me by law, did on the 21st day of July A. D. 1930, appoint J. H. Therrell, as Liquidator for the Bank of Bay Biscayne of Miami, Florida, and I further certify that the said J. H. Therrell has executed his bond in the form and amount required by his appointment, which said bond has been filed with and approved by me as Comptroller of the State of Florida as provided by law.

In Testimony Whereof I have hereunto set my hand and official seal at the Capitol at Tallahassee, Florida, this 10th day of July A. D. 1931.

(Signed) ERNEST AMOS,
Comptroller of the State of Florida.

(Official Seal)

33 EXHIBIT "C".

Appointment of Liquidator.

Clerk's File F 20301.

Dated .....

Filed July 30, 1930.

Recorded in Deed Book 1395 page 143.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County Florida. At Law No. 13282.

In Re: The Liquidation of the Biscayne Trust Company, a corporation doing business at Miami, Florida.

Having become satisfied from the report of the State Bank Examiner that the Biscayne Trust Com-

pany of Miami, Florida, a corporation duly organized and authorized to conduct a banking business under the laws of the State of Florida, at Miami, Florida, has become insolvent and is unable to meet its obligations, I do hereby appoint the Guardian Trust Company, of Miami, Florida, in the County of Dade, State of Florida, with all the usual powers and duties of Liquidators for the purpose of closing up the affairs of the Biscayne Trust Company, of Miami, Florida, and the said Biscayne Trust Company, being hereby directed to forthwith deliver all of its property of any nature whatsoever, real and personal, things in action, moneys, books, debts, legal and equitable, and all property and effects of any nature and description whatsoever of said bank to the said Liquidator and the said Liquidator being next hereby authorized and directed to be governed in all its acts and doings relative to said property by laws of the State of Florida and the directions of the Comptroller and the orders of the Court, the said Liquidator being especially authorized to take immediate charge of said property of said bank, and to proceed at once to the collection of all amounts due to the said Biscayne Trust Company of Miami, Florida.

In Testimony Whereof, I have hereunto set my hand and official seal at the Capitol at Tallahassee, this July 25, 1930.

(Signed) ERNEST AMOS,
Comptroller, State of Florida.

(Official Seal).

Comptroller's Office, State of Florida.

To the Honorable Judge of the Circuit Court of the Eleventh Judicial Circuit, State of Florida:

It appearing by the report of a State Bank Examiner that the Biscayne Trust Company of Miami, was insolvent and unable to meet its liabilities, I did on July 25, 1930, appoint the Guardian Trust Company, as

Liquidator of said bank, in pursuance of the provisions of Section 19, of Chapter 13576, Laws of Florida, a copy of said appointment being herewith attached, and did on July 25, 1930, address to Jas. H. Gil-
34 man, President, of the Biscayne Trust Company, Miami, Florida, the following notice:

Mr. Jas. H. Gilman, President,
Biscayne Trust Company,
Miami, Florida.

Dear Sir:

I did on July 25, 1930, appoint the Guardian Trust Co., as Liquidator of the Biscayne Trust Company of Miami, Florida, acting under and in pursuance of the provisions of Section 19, of Chapter 13576, laws of Florida, and you are hereby notified that on July 31, 1930, or as soon thereafter as the same may be heard, I will apply to the Honorable Judge of the Eleventh Judicial Circuit of Florida, at Miami, Florida, for an order confirming my action in ascertaining that the Biscayne Trust Company of Miami, Florida, was and is insolvent and in appointing Guardian Trust Company, as Liquidator thereof.

Yours very truly,
(Signed) ERNEST AMOS,
Comptroller, State of Florida.

State of Florida,
County of Dade.

Before the undersigned, a Notary Public, in and for the State of Florida, at Large, personally appeared Geo. C. White, who being first duly sworn, says: That he is a State Bank Examiner, and as such is the agent of the Comptroller of the State of Florida, that in pursuance to instructions, given him by the said Comptroller, he did make an examination of the Biscayne Trust Company of Miami, Florida, doing a banking business at said place, and that from said examination according to his own knowledge in part and upon in-

formation and belief, as to the remainder, the said affiant believes that the Biscayne Trust Company, of Miami, Florida, is insolvent and unable to meet its obligations, and is now closed and in the hands of the Comptroller of the State of Florida.

(Signed) GEO. C. WHITE,
State Bank Examiner.

Sworn to and subscribed before me this July 25, 1930.

(Signed) PAULINE CORLEY,
(N. P. Seal) Notary Public, State of Florida at Large. Commission expires November 19, 1930.

Comptroller's Office, State of Florida.

I respectfully petition and apply to Your Honor for a confirmation of my action in appointing the Guardian Trust Company, as Liquidator of the Biscayne Trust Company, a corporation, doing a banking business at Miami, Florida, and submit the attached affidavit of State Bank Examiner, George C. White, setting forth that at the time the said appointment was made, the said Biscayne Trust Company, of Miami, Florida, was insolvent, and in default, and assuring Your Honor that should any other or further evidence be deemed necessary by you I am ready to comply with any request that you may make in the premises.

(Signed) ERNEST AMOS,
Comptroller, State of Florida.

State of Florida;
County of Dade.

Before the subscriber, an officer authorized to administer oaths under the laws of the State of Florida, personally appeared Jas. H. Gilman who being duly sworn deposes and says: that he is the President of the Biscayne Trust Company of Miami, Florida, a corporation duly chartered and existing under the laws of

the State of Florida, to do a banking business and that on behalf of said bank he accepts service of notice of the Comptroller and waives further consideration in the matter of the appointment of ..... Liquidator of the Biscayne Trust Company, of Miami, Florida.

(Signed) JAMES H. GILMAN,
President.

Sworn to and subscribed before me this July 28, 1930.

(Signed) PAULINE CORLEY,
Notary Public State of Florida at Large. Commission expires November 19, 1930.

(Notary Public Seal.)

ORDER CONFIRMING APPOINTMENT OF LIQUIDATOR.

Clerk's File F 20300.

Dated .....

Filed July 30, 1930.

Recorded in Deed Book 1395 page 142.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County Florida. No. 13282.

Ernest Amos, Comptroller, State of Florida,
vs.
Biscayne Trust Company, Miami, Florida.

This cause coming on to be heard upon petition of Ernest Amos, Comptroller, of the State of Florida, for an order confirming the appointment of a liquidator for the Biscayne Trust Company, of Miami, Florida, by the said Comptroller, and it appearing by evidence submitted that the said Corporation is insolvent and

that the President of said Bank has waived
36 further consideration and consented to the immediate appointment of a Liquidator, as aforesaid, and the Court being fully advised in the premises;

It is thereupon ordered, adjudged and decreed that the appointment of a liquidator for the said Biscayne Trust Company of Miami, Florida, by the Comptroller of the State, is hereby approved and confirmed and the said liquidator is hereby vested with all the powers conferred upon receivers or liquidators for banks under the laws of the State of Florida subject to the restrictions contained in such laws.

Done and ordered at Chambers at 29th, Florida, this the 29th day of July, A. D. 1930.

(Signed) ULY O. THOMPSON,
Circuit Judge.

Note: This instrument was recorded July 29, 1930, in Circuit Court Minutes No. 52, page 91, Public Records of Dade County, Florida.

RESIGNATION OF LIQUIDATOR AND APPOINTMENT OF SUCCESSOR LIQUIDATOR.

Filed March 31, 1931.

Recorded in Circuit Court Minute Book 56 page 482.

In Re: Liquidator Biscayne Trust Company.

In the Circuit Court of the Eleventh Judicial Circuit of Florida in and for Dade County. Common Law. No. 13282.

In Re: The Liquidation of The Biscayne Trust Company, a corporation doing business at Miami, Florida.

It appearing that The Guardian Trust Company, heretofore the duly appointed and qualified Liquidator

of the Biscayne Trust Company of Miami, Florida, having tendered its resignation, and it further appearing that it is for the best interest of the Biscayne Trust Company of Miami, that a successor be appointed to the aforesaid Guardian Trust Company, Liquidator, resigned; therefore I, Ernest Amos, Comptroller of the State of Florida, acting under and in pursuance of the authority vested in me by law do hereby accept the resignation of the said Guardian Trust Company, as Liquidator of the Biscayne Trust Company of Miami, Florida, and hereby direct that, upon qualification of its successor by giving bond, the said Guardian Trust Company, shall immediately transfer and deliver to its successor, J. H. Therrell, who this day has
37 been appointed as Liquidator to succeed the said Guardian Trust Company, all of the property of every kind and description in its possession or under its control or anywise belonging to or pertaining to the said Biscayne Trust Company of Miami, Florida, for which it has been acting as Liquidator. And I further direct that the said Guardian Trust Company, Liquidator, make up and deliver to its successor, J. H. Therrell, a full and complete statement of all the assets and liabilities and of all the property of any kind and description belonging to the Biscayne Trust Company of Miami, Florida.

In Testimony Whereof, I have hereunto set my hand and official seal at the Capitol, at Tallahassee, Florida, this the 27th day of March, A. D. 1931.

ERNEST AMOS,

(Official Seal) Comptroller, State of Florida.

Appointment of Liquidator.

Whereas, it was deemed advisable and for the best interest of the Biscayne Trust Company, of Miami, Florida, to accept the resignation of the Guardian Trust Company, as Liquidator of such Trust Company and

to appoint a successor as Liquidator, who was appointed by me under authority granted by the provisions of Section 4166 of the Revised General Statutes of Florida, I do hereby appoint J. H. Therrell, as Liquidator for the Biscayne Trust Company of Miami, Florida, upon the said J. H. Therrell, executing and filing a bond in the usual form payable to Doyle E. Carlton, Governor of the State of Florida, and his successor in office in the penal sum of $25,000.00, and the bond to be approved by the Comptroller, as provided by law; and the said Guardian Trust Company of Miami, Florida, is hereby directed to forthwith deliver all of its property of any nature whatsoever, real and personal, things in action, moneys, books, debts, legal and equitable, and all its property and effects of any nature and description whatsoever to the said Liquidator, and the said Liquidator, J. H. Therrell is hereby authorized and directed to be governed in his acts and doings relative to said property by the laws of the State of Florida, and the directions of the Comptroller and the orders of the Court, and the said Liquidator being especially authorized to take immediate charge of said property of said Trust Company upon his giving bond herein mentioned, and to proceed at once to collect all accounts due to said trust money.

In Testimony Whereof, I have hereunto set my hand and official seal at the Capitol, at Tallahassee, Florida, this the 27th day of March, A. D. 1931.

ERNEST AMOS,

(Official Seal) Comptroller, State of Florida.

38 EXHIBIT "D"

Appointment of Liquidator.

Clerk's File No. G11170.

Filed May 26, 1931.

Recorded in Deed Book 1440 Page 549.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, Common Law No. 13986.

In Re: The Liquidation of the Guardian Trust Company, a corporation doing a banking business at Miami, Florida.

Having become satisfied from the report of State Bank Examiner that the Guardian Trust Company, a corporation duly chartered and authorized to do a banking business under the laws of the State of Florida at Miami, Florida, has become insolvent and is in default, I do hereby appoint J. H. Therrell as Liquidator of the said Guardian Trust Company doing business at Miami, Florida, in the County of Dade, State of Florida, with all the usual powers and duties of a Liquidator by virtue of Section 19, Chapter 13576, Laws of Florida, for the purpose of closing out and winding up the affairs of the said Guardian Trust Company upon the said J. H. Therrell executing and filing a bond in the usual form payable to Doyle E. Carlton, Governor of the State of Florida, and his sucessors in office in the penal sum of Thirty Thousand Dollars ($30,000.00) to be approved by the Comptroller, as provided by law and the said Guardian Trust Company being hereby directed to forthwith deliver all of its property of any nature whatsoever, real and personal, things in action, moneys, books, debts,

legal and equitable and all property and effects of any nature and description whatsoever of said Guardian Trust Company to the said Liquidator and the said Liquidator is hereby authorized and directed to be governed in all his acts and doings relative to said property by the laws of the State of Florida, and the ratification of the Comptroller and the orders of the Court, the said Liquidator being especially authorized to take immediate charge of said property of said bank upon the approval of the bond herein mentioned, and to proceed at once to collection of all amounts due to the said Guardian Trust Company of Miami, Florida.

In Testimony Whereof, I have hereunto set my hand and official seal at the Capitol, Tallahassee, Florida, this the 9th day of May, A. D. 1931.

(Signed) ERNEST AMOS,
(Official Seal) Comptroller, State of Florida.

39 Comptroller's Office State of Florida.

To the Honorable Judge of the Circuit Court of the Eleventh Judicial Circuit: State of Florida:

It appearing by the report of a State Bank Examiner that the Guardian Trust Company of Miami, Florida, was insolvent and unable to meet its liabilities, I did on the 9th day of May, A. D. 1931, appoint J. H. Therrell as Liquidator of said Bank in pursuance of the provisions of Section 19, of Chapter 13576, Laws of Florida, a copy of said appointment being herewith attached; and did on the 9th day of May A. D. 1931 address to Morgan S. McCormick, President of the Guardian Trust Company the following notice:

Mr. Morgan S. McCormick, President,
Guardian Trust Company,
Miami, Florida.

Dear Sir:

I did on the 9th day of May A. D. 1931, appoint J. H. Therrell as Liquidator of the Guardian Trust

Company of Miami, Florida, acting under and in pursuance of the provisions of Section 19, of Chapter 13576, Laws of Florida, and you are hereby notified that on the 14th day of May A. D. 1931, or as soon thereafter as the same may be heard, I will apply to the Honorable ..... Judge of the Eleventh Judicial Circuit Court of Florida at Miami, Florida, for an order confirming my action in appointing a Liquidator thereof.

Yours very truly,
(Signed) ERNEST AMOS,
Comptroller, State of Florida.

Comptroller's Office State of Florida.

I respectfully petition and apply to Your Honor for a confirmation of my action in appointing a Liquidator for the Guardian Trust Company, a Corporation doing a banking business at Miami, Florida, and submit the attached affidavit of State Bank Examiner A. W. Saarinen setting forth that at the time the said appointment was made, the said Guardian Trust Company of Miami, Florida, was in default and believed to be insolvent, and assuring Your Honor that should any other or further evidence be deemed necessary by you I am ready to comply with any request that you may make in the premises.

(Signed) ERNEST AMOS,
Comptroller, State of Florida.

Before The Undersigned, a Notary Public in and for the State of Florida at Large, personally appeared A. W. Saarinen, who being first duly sworn says: that he is a State Bank Examiner and as such is the agent of the Comptroller of the State of Florida; that in pursuance to instructions given him by the said Comptroller, he did make an examination of the Guardian Trust Company of Miami, Florida, doing a banking and trust business at said place, and that from said

examination, according to his own knowledge in part and upon information and belief as to the remainder, the said affiant believes that the Guardian Trust Company of Miami, Florida, is insolvent and unable to meet its obligations, and is now closed.

(Signed) A. W. SAARINEN,
State Bank Examiner.

Sworn To And Subscribed before me this the 9th Day of May A. D. 1931.

(Signed) ANNA W. CLAPP,
Notary Public, State of Florida at Large. My commission expires Mar. 15, 1933.

(Notary Public Seal).

41 State of Florida,
County of Dade.

Before The Subscribed, an officer authorized to administer oaths under the laws of the State of Florida, personally appeared Morgan S. McCormick, who being duly sworn deposes and says: that he is the President of the Guardian Trust Company of Miami, Florida, a corporation duly chartered and existing under the laws of the State of Florida, to do a banking and trust business and that on behalf of said bank, he accepts service of notice of the Comptroller and waives further consideration in the matter of the appointment of J. H. Therrell as Liquidator of the Guardian Trust Company of Miami, Florida.

(Signed) MORGAN S. McCORMICK,
President.

Sworn To And Subscribed Before me this the 11th day of May A. D. 1931.

(Signed) RHONA MIXON,
Notary Public, State of Florida at Large. My commission expires Jan. 15, 1932.

(Notary Public Seal).

ORDER CONFIRMING APPOINTMENT OF LIQUIDATOR.

42 Clerk's File No. G.11171.

Filed May 26, 1931.

Recorded in Deed Book 1441 Page 1.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, Common Law No. 13986.

In Re: The Liquidation of the Guardian Trust Company, a corporation doing a banking business at Miami, Florida.

This cause coming on to be heard upon petition of Ernest Amos, Comptroller of the State of Florida for an order confirming the appointment of a Liquidator for the Guardian Trust Company of Miami, Florida, by the said Comptroller, and it appearing by evidence submitted that the said Corporation is insolvent and that the President of said bank has waived further consideration and consented to the immediate appointment of a Liquidator, as aforesaid, and the Court being fully advised in the premises:

It is further ordered, adjudged and decreed that the appointment of a Liquidator for the said Guardian Trust Company of Miami, Florida, by the Comptroller of the State is hereby approved and confirmed and the said liquidator is hereby vested with all the powers conferred upon receivers or liquidators for banks under the laws of the State of Florida subject to the restrictions contained in such laws.

Done And Ordered at Chambers at Miami, Florida, this the 22 day of May A. D. 1931.

(Signed) ULY O. THOMPSON,
Circuit Judge.

43 ORDER.

Filed May 26, 1931.

Recorded in Deed Book 1441, page 3.

Clerk's File No. G11172.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, Common Law No. 13986.

In Re: The Liquidation of the Guardian Trust Company, a corporation doing a banking business at Miami, Florida.

On this the 23rd day of May A. D. 1931, there appeared before the Court Lilburn R. Railey, William H. Burwell, and H. H. Taylor, as amicus curie, and called the Court's attention to that certain rule to show cause heretofore issued by the Supreme Court of the State of Florida, to-wit: The 20th day of May, A. D. 1931, in that certain cause therein pending, to-wit: The State of Florida, ex rel, Cary D. Landis, Attorney General, Relator, versus The Circuit Court for the Eleventh Judicial Circuit of Florida, H. F. Atkinson, Circuit Judge of the Eleventh Judicial Circuit of Florida, Will Allen and Henry Taylor, Respondents; and it appearing from an inspection of said rule to show cause that same is, among other things, directed to "The Circuit Court for the Eleventh Judicial Circuit of Florida", and the Court having inspected and being advised as to the contents of said writ of prohibition, thereupon, orders, adjudges and decrees as follows, to-wit: First: That the order heretofore entered by this Court in the matter of The Guardian Trust Company on, to-wit: The 22nd day of May, A. D. 1931, confirming the appointment of J. H. Therrell, as Liquidator of said Guardian Trust Company, be, and the same

is hereby vacated, annulled, and set aside, the Court being of the opinion at this time that the confirmation of said J. H. Therrell, as said Liquidator, was in violation of the rule to show cause hereinbefore referred to; and, to the ontry of this order, Carl T. Hoffman appearing for the said J. H. Therrell, and Ernest Amos, Comptroller, hereby excepts.

Done And Ordered in Chambers at Miami, Florida, on this 23rd day of May A. D. 1931.

(Signed) ULY O. THOMPSON,
Circuit Judge.

PETITION OF ERNEST AMOS, COMPTROLLER OF THE STATE OF FLORIDA FOR AN ORDER CONFIRMING THE APPOINTMENT OF A LIQUIDATOR OF GUARDIAN TRUST COMPANY.

44 Filed July 11, 1931.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, Common Law No. 13986.

In Re: The Liquidation of the Guardian Trust Company, a corporation doing a banking business at Miami, Florida.

Now comes Ernest Amos, as Comptroller of the State of Florida and petitions this Court to approve and confirm the appointment by the said Ernest Amos as Comptroller of the State of Florida of a Liquidator for the Guardian Trust Company, a corporation heretofore doing business under the Banking and Trust laws of the State of Florida, said appointment of a Liquidator of said institution and the proceedings in-

cident thereto and connected therewith more fully appearing from the record in this cause on file in this Court.

(Signed) CARL T. HOFFMAN,
Counsel for Ernest Amos,
Comptroller of the State
of Florida.

ORDER CONFIRMING APPOINTMENT OF LIQUIDATION FOR GUARDIAN TRUST COMPANY.

45 Clerk's File No. G14835.

Filed July 20, 1931.

Recorded in Deed Book 1449, page 91.

In the Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, Common Law No. 13986.

In Re: The Liquidation of the Guardian Trust Company, a corporation doing a banking business at Miami, Florida.

This cause coming on to be heard upon petition of Ernest Amos, Comptroller of the State of Florida, for order confirming the appointment by the said Comptroller of a Liquidator of The Guardian Trust Company, of Miami, Florida, and it appearing to the Court by the evidence submitted that the said appointment of a Liquidator of the said The Guardian Trust Company is regular, lawful and proper, and that the said The Guardian Trust Company having by its President waived further consideration or notice of this application and consented to the appointment of a Liquidator

for said institution, and it appearing to the Court that an Order of this Court confirmed the appointment of a Liquidator of this institution was made by this Court on the 22nd day of May, A. D. 1931, and that said Order of this Court of May 22, 1931, was vacated and set aside by the Order of this Court of May 23, 1931, upon the theory that said Order of May 22, 1931, was prematurely entered for the reasons recited in the Order of this Court of May 23, 1931;

And it now appearing to this Court that the appointment of a Liquidator for The Guardian Trust Company should now be confirmed in view of the decision and judgment of the Supreme Court of the State of Florida in the case of State of Florida, Ex Rel. Cary D. Landis, Attorney-General, Relator vs. Circuit Court of the Eleventh Judicial Circuit of Florida, et als. Respondents;

46 Now, Therefore, upon consideration of the petition of the said Ernest Amos, as Comptroller of the State of Florida for the confirmation of the appointment by the said Ernest Amos as Comptroller of the State of Florida of a Liquidator for said The Guardian Trust Company, it is

Considered, Ordered, Adjudged and Decreed that the appointment by Ernest Amos, as Comptroller of the State of Florida of J. H. Therrell, as Liquidator for the said The Guardian Trust Company, of Miami, Florida, be and the same is hereby approved and confirmed, and the said Liquidator so appointed by the said Comptroller is hereby vested with all the powers conferred upon Liquidators for banks and trust companies under the Laws of the State of Florida, subject to the restrictions contained in such laws.

Done And Ordered in Miami, Dade County, Florida, this 11th day of July, A. D. 1931.

(Signed) ULY O. THOMPSON,
Circuit Judge.

47 EXHIBIT "E".

No. 1.

In the Circuit Court of the Eleventh Judicial Circuit of Florida in and for Dade County. No. 14286.

In Re: Liquidation of Trust Company of Florida, a corporation doing a trust business at Miami, Florida.

It appearing by the report of a State Bank Examiner that The Trust Company of Florida of Miami, Florida was in an unsound condition, I did on the 27th day of November, A. D. 1931, appoint J. H. Therrell, as Liquidator of said Trust Company in pursuance of the provisions of Section 19 of Chapter 13576, Laws of Florida, a copy of said appointment being herewith attached; and did on the 27th day of November, A. D. 1931, address to Mr. J. V. Hardeman, Vice-President of the Trust Company of Florida, the following notice:

Mr. J. V. Hardeman, Vice-President,
Trust Company of Florida,
Miami, Florida.

Dear Sir:

I did on the 27th day of November, A. D. 1931, appoint J. H. Therrell as Liquidator of the Trust Company of Florida, of Miami, Florida, acting under and in pursuance of the provisions of Section 19 of Chapter 13576, Laws of Florida, and you are hereby notified that on the Third day of December, A. D. 1931, or as soon thereafter as the same may be heard, I will apply to the Honorable Judge of the Eleventh Judicial Circuit Court of Florida, at Miami, Florida, for an order confirming my action in ascertaining that the Trust Company of Florida of Miami, Florida, was in an unsound condition and in appointing J. H. Therrell as Liquidator thereof.

Yours very truly,
(Signed) ERNEST AMOS,
Comptroller, State of Florida.

48 Comptroller's Office—State of Florida.

I respectfully petition and apply to Your Honor for a confirmation of my action in appointing a Liquidator for Trust Company of Florida, a Corporation doing a banking business at Miami, Florida, and submit the attached affidavit of State Bank Examiner, L. E. Fenn, setting forth that at the time the said appointment was made the said Trust Company of Florida of Miami, Florida, was in an unsound condition and assuring your Honor that should any other or further evidence be deemed necessary by you, I am ready to comply with any request that you may make in the premises.

ERNEST AMOS,
Comptroller State of Florida.

Appointment of Liquidator.

Having become satisfied from the report of State Bank Examiner that the Trust Company of Florida, of Miami, Florida, a corporation duly chartered and authorized to do a trust business under the laws of the State of Florida, is in an unsound condition I do hereby appoint J. H. Therrell, Liquidator of the said Trust Company of Florida, doing business at Miami, Florida, with all the usual powers and duties of a Liquidator by virtue of Section 19, Chapter 13576, Laws of Florida, for the purpose of closing out and winding up the affairs of the Trust Company of Florida upon the said J. H. Therrell executing and filing a bond in the usual form payable to Doyle E. Carlton, Governor of the State of Florida, and his successors in office in the penal sum of Twenty-five Thousand Dollars ($25,000) to be approved by the Comptroller as provided by law and the said Trust Company of Florida being hereby directed to forthwith deliver all of its property of any nature whatsoever, real and personal, things in action, money, books, debts, legal and equit-

able and all property and effects of nature and description whatsoever of said bank to the said Liquidator and the said Liquidator is hereby authorized and directed to be governed in all his acts and doings relative to said property by the laws of the State of Florida and the ratification of the Comptroller and the orders of the Court, the said Liquidator being especially authorized to take immediate charge of said property of said Bank upon the approval of the bond herein mentioned and to proceed at once to collection of all amounts due to the said Trust Company of Florida, of Miami, Florida.

In Testimony Whereof I have hereunto set my hand and official seal at the Capitol, Tallahassee, Florida, this the 27th day of November A. D. 1931.

ERNEST AMOS,

(Seal) Comptroller, State of Florida.

49 Before The Undersigned, a Notary Public in and for the State of Florida at Large, personally appeared L. E. Fenn, who being first duly sworn says: that he is a State Bank Examiner and as such is the agent of the Comptroller of the State of Florida; that in pursuance to instructions given him by the said Comptroller he did make an examination of the Trust Company of Miami, Florida, doing a trust business at said place and that from said examination according to his own knowledge in part and upon information and belief as to the remainder the said affiant believes that the Trust Company of Florida, of Miami, Florida is in an unsound condition by reason of litigation now pending against the company which litigation would probably render the Company unable to meet its obligations; and the said Trust Company of Florida, is now closed and in the hands of the Comptroller of the State of Florida.

L. E. FENN,

State Bank Examiner.

Sworn to and subscribed before Notary Public of Florida, Nov. 27, 1931. Seal affixed. Commission expires: April 11, 1934.

State of Florida,
County of Dade.

Before the subscribed officer authorized to administer oaths under the laws of the State of Florida, personally appeared J. V. Hardeman, Vice-President, who being duly sworn, deposes and says: that he is the vice-president of the Trust Company of Florida, of Miami, Florida, a corporation chartered and existing under the laws of the State of Florida, to do a trust business and that on behalf of said Trust Company, he accepts service of notice of the Comptroller and waives further consideration in the matter of the appointment of J. H. Therrell, as Liquidator of the Trust Company of Florida, of Miami, Florida.

J. V. HARDEMAN,
Vice-President.

Sworn to and subscribed before a Notary Public of Florida, December 3, 1931. Seal Affixed. Commission expires; July 17, 1934.

Note: The above instrument, Item No. 2, was filed for record December 8, 1931, recorded in Circuit Court Minute Book 62, page 179, recorded December 8, 1931, in Chancery Order Book 254, page 407 and re-recorded December 9, 1931 in Deed Book 1467, page 287.

50 No. 2.

Same Cause,
Same Court.

This cause coming on before this Court to be heard pursuant to Section 6102 of the Compiled General Laws of Florida for the confirmation of the act of the

Comptroller in appointing a liquidator for the Trust Company of Florida, and it has been made to appear by oral representatives to the Court that there is a certain suit pending in the Federal Court for the appointment of a receiver for said Trust Company of Florida and that by reason thereof this Court should defer confirming the act of the comptroller in appointing a liquidator until the said Federal Court suit has been finally determined upon the basis of commity between the Courts but it appearing unto this Court that the comptroller is now in possession of said Trust Company of Florida and that even after confirmation of his act in appointing a liquidator that such would not deprive any Court of its jurisdiction and that even in the event of the appointment of a receiver by the Federal Court after the confirmation of the act of appointing a liquidator by the comptroller it would then become the duty of the administrative officer to yield to the jurisdiction of such or any Court in the proper exercise of its jurisdiction and it further appearing that the act of the comptroller should be confirmed;

It Is Considered; Ordered And Adjudged that an order be entered accordingly.

Done And Ordered at Miami, Florida this 8th day of December, A. D. 1931.

PAUL D. BARNES,
Circuit Judge.

Note: The above instrument Item No. 3 was recorded December 8, 1931 in Circuit Court Minute Book 62, page 184, recorded December 8, 1931 in Chancery Order Book 254, page 412 and recorded December 9, 1931 in Deed Book 1467, page 286 of the Public Records of Dade County, Florida.

No. 3.

Order Confirming Appointment of Liquidator.

Same Cause,
Same Court.

This cause coming on to be heard upon petition of Ernest Amos, Comptroller of the State of Florida, for an order confirming his action and (or in) the appointment of a liquidator for the Trust Company of Florida, of Miami, Florida, by the said Comptroller and it appearing that the said corporation is in an unsound condition and that the Vice-President of the said Trust Company for and on behalf of said company has waived further consideration in the matter of appointment of a liquidator as aforesaid and the Court being fully advised in the premises;

51

It is therefore Considered, Ordered, Adjudged and Decreed that the action of said Amos, as comptroller as aforesaid and (or in) the appointment of a liquidator for the said Trust Company of Florida of Miami, Florida, by the Comptroller of the State is hereby approved and confirmed.

Done and ordered at Chambers at Miami, Florida, this 8th day of December A. D. 1931.

PAUL D. BARNS,
Circuit Judge.

Note: The above instrument, Item No. 4, was recorded December 8, 1931, in Circuit Court Minute Book 62, page 185, re-recorded December 8, 1931 in Chancery Order Book 254, page 413 and re-recorded December 9, 1931, in Deed Book 1467, page 292 of the Public Records of Dade County, Florida.

52 ANSWER.

Received May 7, 1935.

Filed May 7, 1935.

(Title Omitted.)

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, in answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits so much of paragraph 3 of the petition as alleges that the taxes in controversy are income taxes for the calendar years 1931 and 1932, and denies all other allegations contained in said paragraph 3.

4. Denies that the respondent, in determining the deficiency tax, committed errors as alleged in paragraph 4 of the petition.

5. Admits so much of paragraph 5 of the petition as alleges that the petitioner was appointed Liquidator of certain banks by Comptroller of the State of Florida; that he received fees as shown in the deficiency notice, for services rendered; and denies the remaining allegations contained in said paragraph 5.

53 6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore it is prayed that the determination of the Commissioner be approved.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel for the Bureau of Internal Revenue.

Of Counsel:

C. A. RAY,
Special Attorney, Bureau of Internal Revenue.

CAR/y 5/6/35.

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54 MEMORANDUM OPINION.

United States Board of Tax Appeals.

John H. Therrell, also known as J. H. Therrell, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Docket No. 78961.

H. M. Hampton, Esq., for the petitioner.

C. A. Ray, Esq., for the respondent.

SMITH:

This proceeding involves deficiencies in petitioner's income tax for 1931 and 1932 in the amounts of $108.78 and $6,329.53, respectively, all of which deficiencies are in dispute.

The only question in issue is whether the compensation received by the petitioner during the taxable years for his services as bank liquidator under appointment by the Comptroller of the State of Florida is exempt from Federal income tax.

The petitioner was appointed liquidator of the Bank of Bay Biscayne, a State banking institution of the

State of Florida, located at Miami, Florida,
55 in July, 1920. At that time he was employed as president of a bank at Ocala, Florida. Thereafter, he was appointed liquidator of several other similar institutions within the State. The appointment of liquidators to administer insolvent banking institutions by the Comptroller of the State is authorized by the statutes of Florida. See section 19, chapter 13576 (1929) or 4162 Revised General Statutes, 6102 Compiled General Laws.

The petitioner in assuming his duties as liquidator received no commission from the Governor of the State and took no oath of office. He was appointed by and served entirely at the pleasure of the Comptroller. He was required to give bond in each of the undertakings.

As liquidator the petitioner's duties were to look after the Court litigation involving the liquidating banks and to dispose of their assets to the best advantage of the depositors and others concerned. He exercised supervision over a number of other persons employed in various capacities to assist in the liquidation of the several banks and was himself under the direct supervision of the Comptroller. He devoted all of his working time to these duties in both the years 1931 and 1932 except for occasions when he would attend directors' meetings of the bank at Ocala of which he was still president on an inactive status, and the bank paid the cost of his transportation to and from the directors' meetings.

The amount of the petitioner's compensation for his services in liquidating the several institutions was determined and paid to him by the Comptroller on a commission basis not in excess of five per cent of the amounts collected by him and turned in to the State treasury. He received small amounts from time to time on warrants issued by the Comptroller and upon

the completion of each liquidation received the balance due him under the final accounting. His total compensation from this source amounted to $8,555.61 in 1931 and $39,448.07 in 1932.

56 Whether these amounts are exempt from Federal income tax on the constitutional ground that the imposition of the tax would result in a forbidden interference by the Federal government with the State of Florida in the exercise of an essential governmental function is the only question here in issue. See *McCulloch* v. *State of Maryland, et al.*, 4 Wheat. 316; *The Collector* v. *Day* 11 Wall. 113, and cases following.

On the facts in this proceeding the question presented is not materially different from that decided by the Board in *Carl Newman Davis*, 26 B. T. A. 1007. We there held that the constitutional exemption from taxation did not apply to compensation received by the taxpayer for legal services rendered in liquidating certain insolvent State banking institutions under direction of the Superintendent of Banks of the State of Georgia.

The numerous cases bearing on this question are not entirely harmonious. A majority of those cases, however, support the view which we have adopted here that the taxpayer was an independent contractor and that the proposed tax would not result in any serious impairment of the State's governmental functions.

In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, the Court said:

"It is on this principle that, as we have seen, any taxation by one government of the salary of an officer

of the other, or the public securities of the other, or an agency created and controlled by the other, exclusively to enable it to perform a governmental function (*Gillespie* v. *Oklahoma, supra*), is prohibited. But here the tax is imposed on the income of one who is neither an officer nor an employee of government and whose only relation to it is that of contract, under which there is an obligation to furnish service, for practical purposes not unlike a contract to sell and deliver a commodity. In such a situation it cannot be said that the tax is imposed upon an agency of government in any technical sense, and the tax itself cannot be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way. *Railroad Co. v. Peniston; Gromer v. Standard Dredging Co.; Baltimore Shipbuilding Co. v. Baltimore; Fidelity & Deposit Co. v. Pennsylvania; Choctaw, O. & G. R. R. Co. v. Mackey, supra.*"

57 In our opinion the imposition of the proposed tax on the compensation which the petitioner received on a percentage basis out of the monies recovered by him for assisting the State Comptroller in the liquidation of the banking institutions does not place a prohibited burden upon the State of Florida in the exercise of its governmental functions. See also *Helvering v. Powers*, 293 U. S. 214; *Gardner Abbott*, 30 B. T. A. 227; *Emory R. Buckner*, 31 B. T. A. 84, affd., 77 Fed. (2d) 297; *Commissioner v. Murphy*, 70 Fed. (2d) 790; *George Z. Medalie*, 30 B. T. A. 1284; *D. F. Strickland*, 32 B. T. A. 804.

Judgment will be entered for the respondent.

Enter: Entered May 21, 1936.

58 DECISION.

United States Board of Tax Appeals Washington.

John H. Therrell, also known as J. H. Therrell, Petitioner,
v. Docket No. 78961.
Commissioner of Internal Revenue, Respondent.

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion entered May 21, 1936, it is

Ordered and Decided: That there are deficiencies of $108.78 and $6,329.53 for the years 1931 and 1932, respectively.

Enter: Entered May 21, 1936.
(Signed) CHARLES P. SMITH,
(Seal) Member.

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59 PETITION FOR REVIEW.

Filed July 13, 1936.

(Title Omitted.)

The petition of John H. Therrell, also known as J. H. Therrell, hereinafter called petitioner, respectfully shows:

I. Petitioner is an individual, citizen of the United States, residing at Ocala, Florida, and filed his federal income tax return for the calendar years 1931 and 1932 with the United States Collector of Internal Revenue at Jacksonville, Florida, whose collection

district is within the jurisdiction of the United States Circuit Court of Appeals for the Fifth Circuit.

60 Nature of Controversy.

II. The controversy which petitioner desires to have reviewed arises out of respondent's disallowance of certain sums of money paid to petitioner as compensation for services rendered by him as Liquidator for one certain bank and three certain trust companies in Miami, Florida, during the years 1931 and 1932 respectively, as hereinafter stated, which moneys petitioner claims were exempt to him as compensation paid a state officer or employee, and as such were exempt from federal income taxes.

Before the said Board of Tax Appeals petitioner alleged and showed, and the Board found as facts, that petitioner was (1) appointed by the Comptroller of the State of Florida on July 22, 1930, to be Liquidator of the Bank of Bay Biscayne, a state banking corporation doing business in Miami, Florida; (2) appointed by the Comtroller of the State of Florida on March 27,
61 1931, to be Liquidator of the Biscayne Trust Company, a trust company doing business in Miami, Florida; (3) appointed by the Comptroller of the State of Florida on May 9, 1931, to be Liquidator of the Guardian Trust Company, a trust company doing business in Miami, Florida; (4) appointed by the Comptroller of the State of Florida on November 27, 1931, to be Liquidator of the Trust Company of Florida, a trust company doing business in Miami, Florida.

That the amount of petitioner's compensation for his services in liquidating the several institutions was paid to him by the Comptroller of Florida on a commission basis not in excess of 5% of the amounts collected by him and turned over to the State Treasurer.

That his total compensation in 1931 was $8555.61, and in 1932 was $39,448.07.

Upon this finding the Board of Tax Appeals held that petitioner was an independent contractor as distinguished from an employee of the State of Florida, and that the proposed tax would not result in impairment of the state's governmental functions, and then and there denied the petitioner's request for redetermination and entered judgment thereon for the respondent.

62 III. Your petitioner, being aggrieved by the findings of fact, opinion, decision and order of the Board of Tax Appeals of date May 21, 1936, and the judgment entered thereon as aforesaid, petitions for a review of said decisions and order by the United States Circuit Court of Appeals for the Fifth Circuit, and as grounds for said review, alleges that the Board in rendering its decision, and in entering its final order, committed the following errors:

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63 ASSIGNMENTS OF ERROR.

1. The Honorable Board of Tax Appeals erred in finding that because this petitioner held no commission and took no oath of office, and was appointed by and served at the pleasure of the Comptroller of the State of Florida, and the amounts paid him were upon the commission basis, said sums of money were taxable for the respective years in which the same were received.

2. The Honorable Board of Tax Appeals erred in finding and decreeing that the petitioner was an independent contractor, and that the proposed tax would not result in any serious impairment of the State's governmental functions.

3. The Honorable Board of Tax Appeals erred in decreeing and determining that the sums of money paid to petitioner for the year 1931 as compensation for his services for the several institutions mentioned, were taxable as income.

4. The Honorable Board of Tax Appeals erred in decreeing and determining that the sums of money paid to petitioner for the year 1932 as compensation for his services for the several institutions mentioned, were taxable as income.

64 Wherefore, petitioner prays that the order and decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Fifth Circuit; that a transcript of the record therein be prepared in accordance with the law and the rules of said Court and transmitted to the clerk of said Court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said Court.

(S.) H. M. HAMPTON,
Attorney for Petitioner.

P. O. Box 830,
Ocala, Florida.

65 State of Florida,
County of Marion.

H. M. Hampton, being duly sworn, says that he is Attorney of record for John H. Therrell, also known as J. H. Therrell, petitioner herein, and as such is duly authorized to verify the above and foregoing petition for review to the United States Circuit Court of Appeals for the Fifth Circuit; that he has read said petition for review and is familiar with the statements therein contained, and that the same are true to the best of his knowledge and belief.

(S.) H. M. HAMPTON.

Sworn to and subscribed before me, this 10th day of July, 1936.

(S.) MIRIAM BRIDGES,
Notary Public State of Florida at Large.

(Seal)

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66 Filed July 20, 1936.

(Title Omitted.)

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, copies duly certified as correct of the following documents and records in the above entitled cause in connection with a petition for review by the United States Circuit Court of Appeals for the Fifth Circuit filed by John H. Therrell, also known as J. H. Therrell.

67 1. The docket entries of proceedings before the Board.

2. Pleadings before the Board.

3. Findings of fact, opinion and decision of the Board.

4. Petition for review.

5. The statement of evidence.

6. This praecipe.

(S.) H. M. HAMPTON,
Attorney for Petitioner.

Service of the foregoing praecipe and a copy of the petition is hereby acknowledged this 13th day of July, 1936.

(S.) HERMAN OLIPHANT,
Attorney for Respondent.

68 ORDER.

(Title Omitted.)

In connection with the appeal from the decision of the Board in the above-entitled proceeding entered May 21st, 1936, to the United States Circuit Court of Appeals for the Fifth Circuit, petitioner, on July 13, 1936, lodged with this Board a proposed "Statement of the Evidence" for approval by the Board. On July 21, 1936, counsel for the respondent filed objections to the statement of evidence and on July 27, 1936, a "Notice of Objections to Statement of Evidence." In his objections to the statement of evidence filed July 21, 1936, counsel for the respondent states—"it is respectfully shown that the petition for review filed in this case neither assigns error as to the admission or rejection of evidence nor that a finding of the Board is unsupported by any evidence."

Upon an examination of the record the contentions of the respondent are found to be correct. Under Rule II which has been adopted by all the United States Circuit Courts of Appeal and the Court of Appeals for the District of Columbia the petitioner is not entitled to a statement of evidence. Wherefore, it is—

Ordered that petitioner's request for an approval of the statement of evidence lodged is hereby denied.

(Signed) CHARLES P. SMITH,
(Seal) Member.

Dated: July 30, 1936.

CPS:aa.

69 CERTIFICATE.

United States Board of Tax Appeals Washington.

John H. Therrell, also known as J. H. Therrell, Petitioner,
v. Docket No. 78961.
Commissioner of Internal Revenue, Respondent.

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 68, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 13th day of August, 1936.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

(Seal)

That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:—

Argument and submission

Extract from the Minutes of February 1st, 1937

No. 8212

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL

vs.

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, and, after argument by H. M. Voorhis, Esq. for petitioner, and Howard P. Locke, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

March 9, 1937

Before FOSTER, SIBLEY, and HUTCHESON, Circuit Judges

SIBLEY, Circuit Judge: An additional tax was assessed by the Commissioner and sustained by the Board of Tax Appeals against John H. Therrell for the years 1931 and 1932 because of income received by him in those years as liquidator of a number of Florida banks and trust companies. Only question is whether the Federal Constitution prohibits taxation by the United States of this income earned in the service of the State of Florida. The Board held that Therrell was neither officer nor employe of the State of Florida but an independent contractor whose compensation was taxable, relying directly on Davie, et al., 26 B. T. A. 1007, and Metcalf & Eddy vs. Mitchell, 269 U. S. 514.

We judicially notice the statutes of Florida and their provisions for the establishment of banks and trust companies, for their supervision and for their winding up. Comp. Gen. Laws, Secs. 6053 and following, and especially Secs. 6102, 6102 (1), 6104, 6105, relating to liquidators. The State Comptroller when a bank or trust company is found insolvent or threatened with insolvency, or is in an unsound condition or violating the banking laws, "may appoint a liquidator to take charge of the assets and affairs of such bank and require of him such bond and security as the Comptroller deems proper * * * and such liquidator shall be subject to dismissal by the Comptroller. Such liquidator, under the direction and supervision of the Comptroller, shall take possession of the books and records and assets of every description of such bank * * * and in his name shall sue for and collect all debts and claims belonging to it, and upon the order of the court of competent jurisdiction may sell or compound all bad or doubtful debts and on like order may

sell all the real and personal property * * * and sue for and enforce the individual liability of the stockholders. Such liquidator shall pay all money received by him to the State Treasurer to be held as a special deposit * * * and shall make quarterly reports, or when called upon, to the Comptroller." The appointment is, after notice to the bank, confirmed by the Circuit Court. The expenses of liquidation are paid out of the fund in the Treasurer's hands. "The compensation of the liquidator shall be fixed by the Comptroller and shall be based upon the amount of work actually and necessarily performed, and shall in no case exceed five percent of the cash collected." Therrell was appointed liquidator of a number of banks, and gave substantially all his time to the work. He had no commission from the Governor and took no oath of office, but he had formal appointments by the Comptroller under his official seal confirmed by the court, and gave a bond for his faithful conduct touching each bank approved by the Comptroller.

The case of Davie et al cited by the Board, was of attorneys at law who under leave of a statute were employed by the Georgia Superintendent of Banks to do certain legal work touching failed banks, their duties and compensation being entirely matters of private agreement. The conclusion reached that they were independent contractors, mere lawyers practicing their profession though having a public officer as a client, is well supported by the cases of Lucas vs. Howard, 280 U. S. 526, and Lucas vs. Reed, 281 U. S. 690. Metcalf & Eddy vs. Mitchell involved in much the same way consulting engineers. But such is not the case here. The liquidator does not contract with the Comptroller for a desired result, nor do they fix by agreement the liquidator's duties or compensation. The Comptroller appoints him to a public position created by law with duties and responsibilities fixed by law and guaranteed by a bond, and with a compensation also regulated by law. There is a formal commission signed, not by the Governor but by another high State officer. The work to be done includes collecting and suing, but extends to rehabilitation of the bank if possible and to conserving and safeguarding its assets in every way, and if finally insolvent to distributing its assets in conjunction with the Comptroller. He becomes the representative not of the bank or its creditors but of the Comptroller, the instrument of the State for executing its banking laws and doing justice to the bank's creditors and stockholders in its liquidation. He is not chosen by the bank or its creditors, but over their heads. It is superficial to say that they pay him. The State by its officer does that out of the bank's money, not by the consent of the bank or its creditors but by the State's power, an exaction not unlike the levying of a tax for the purpose. He has no contract rights with anyone, for the Comptroller may remove him at any time. All he does is under the direction and subject to the revision of the Comptroller. In Florida Bank & Trust Co. vs. Yaffey, 102 Fla. 723, 136 So. 399, it is said: "A bank liquidator of this

State under the statute providing for his appointment and controlling his duties is a representative and agent of the Comptroller and is not an officer of the court." He takes title to the assets and though the Comptroller has complete power over him a judgment against the liquidator binds the Comptroller. Amos, Comp. vs. Powell, 108 Fla. 139, 146 So. 195. This court said in Amos vs. Trust Co. of Florida, 54 Fed. (2d) 123, "Like the receiver of a national bank, the liquidator though confirmed by a court is not an officer of the court but the representative of the Comptroller." His appointment, powers, and compensation are in complete analogy to those of a national bank receiver under 12 U. S. C. A., Secs. 67, 191, 192. Of such a receiver it was said in Ex parte Chetwood, 165 U. S. 443, 458: "The receiver was not the officer of any court but the agent and officer of the United States"; and in Auten vs. United States, 174 U. S. 125, 141, "A receiver of a national bank appointed by the Comptroller of the Currency is an officer of the United States" as respects the jurisdiction of a federal court. In United States vs. Weitzel, 246 U. S. 533, 541, the court asserts: "The receiver, unlike a president, director, cashier, or teller, is an officer not of the corporation but of the United States. As such he gives to the United States a bond for the faithful discharge of his duties; pays to the Treasurer of the United States moneys collected; and makes to the Comptroller reports of his acts and proceedings. Being an officer of the United States, he is represented in court by the United States attorney subject to the supervision of the Solicitor of the Treasury. And because he is such officer a receiver has been permitted to sue in the federal court regardless of citizenship or the amount in controversy." The function of a national bank receiver could not be taxed by a State by taxing his compensation, and no more can the function of the State bank liquidator be taxed in the same way by the United States.

The classic demonstration that a banking system is a fiscal instrumentality of the national Government which cannot constitutionally be taxed by a State is found in McCullough vs. Maryland, 4 Wheat. 315. The classic counterpart is found in The Collector vs. Day, 11 Wall. 113, where it is shown that the governmental instrumentalities of the States are similarly not taxable by the United States. The taxation of a State judge's salary, though under a general law, was held to be a taxation of his employment as judge, and therefore of the State's administration of justice. These statements of the law have never been departed from or improved upon. Their argument is that the powers of the national and State governments are separated and balanced in the federal Constitution and cannot be used to impede or destroy one another; a constitutional State function is to be protected from aggression equally with a national function; that taxation if allowed on one instrumentality might by the same logic be extended to all; that taxation as to its amount knows no limit except the discretion of the taxing power; so the power to tax

involves the power to destroy. The conclusion is that no taxation at all by one government of the governmental functions and instrumentalities of the other without the latter's consent can safely be allowed or be regarded as constitutional.[1] In this limited field the rule stated is well established, is sound in logic and wise in application. Under it officers and employees of one government cannot generally be taxed by the other on their office or on their compensation. But if the function involved be not really governmental but commercial, as in taking over for operation a business enterprise, the manager though created a public officer is taxable on his income. Helvering vs. Powers, 293 U. S. 214. In Metcalf & Eddy vs. Mitchel, 269 U. S. 514, 522, it is said the immunity extends to "those agencies through which either government immediately and directly exercises its sovereign powers. Thus the employment of officers who are agents to administer its laws * * * is so intimately connected with the necessary functions of government as to fall within the established exemption; and when the instrumentality is of that character the immunity extends not only to the instrumentality itself but to income derived from it." We are of opinion that the establishment and supervision and orderly winding up of State banks is a true governmental function of the State, resting not only on its fiscal needs and powers but also on its police power. The winding up involves also the governmental power of administering justice to its citizens. The bank liquidator, though not a public officer in the full sense, is a public official and an instrumentality appointed by the State to aid directly both in the administration of its banking laws and to do justice to those interested in a failed bank. He takes up where the Comptroller leaves off, and does what the Comptroller, if he had time, might well do himself. The Comptroller, indeed, retains such authority that the liquidator is justly said to be his representative. The liquidator cannot by the United States be taxed on his employment to any extent. If anything is taken from him as tax he would lack that much of receiving what the State law allows him. Compare Dobbins vs. Erie County, 16 Pet. 434, where the compensation of the captain of a United States revenue cutter was involved, and Hoskins vs. Commissioner, 84 Fed. (2d) 627, where the salary of a superintendent of a State public school cafeteria was sought to be taxed. The tax assessed here cannot constitutionally be sustained. The judgment is reversed with direction to eliminate it.

Reversed.

HUTCHESON, Circuit Judge, dissenting:

The view of the majority that to tax petitioner in respect of the compensation he received from the banks he liquidates is to invade and impair the sovereignty of Florida, seems to me illogical and

[1] State taxation of national bank shares is a case of such consent. Baltimore National Bank vs. Tax Commission, 297 U. S. 209.

unreal. Illogical and unreal because by law his compensation is to be, it is in fact, paid not by the State from its own funds, but by each bank he liquidates and from the funds of that bank. I recognize the existence and binding force of the holding that to tax officers and employees of a State actually employed in conducting, or in connection with the conduct of, its governmental functions in respect of their compensation as salaries or wages paid them by the state from its own funds is to burden the state. I realize that it would be vain now to protest that ruling. Texas Co. vs. Carmichael, 13 F. Supp. 247. I think it plain however that the decisions which so hold have pressed the doctrine of governmental immunity to its very verge. To extend the protection of that doctrine as here proposed to one who is neither an officer of the state nor its employee, but a mere agent at the will of or contractee with the Comptroller is, I think, not only without the support of a single authority but contrary to the very reason of the doctrine invoked. That reason, that the state must be free from interference in the exercise of its sovereign powers and that if its officers and agents are subject to be taxed in respect of the compensation it pays them, the state is no longer sovereign but subject, may support the exemption from Federal taxation where the salaries are charged upon and are paid from state funds. It certainly, I think, does not support the exemption of the compensation paid by banks to their liquidators out of their own funds, any more than it exempts the salaries, wages, and so forth, paid to the officers, agents, and employees of the bank who are employed or retained in its service by and under the liquidator.

I do not believe my associates would extend the exemption this far. I have difficulty in making flesh of one and fowl of the other when all are engaged to the same end, in liquidating the bank, and all are under the same general supervision and control of the state Comptroller. It will avail nothing to point out that the supervision and liquidation of banks is a governmental function and the Comptroller, an officer of the state, discharging that function. The liquidator is not an officer of, he draws no salary from, the state. He merely undertakes for and under the appointment of a Comptroller, as a court receiver does for and under the appointment of a court, to handle specific matters of conservation and liquidation when appointed to do so. It will serve no purpose to cite or discuss the great number of authorities according or denying exemption on varying states of facts. It is sufficient to say they all agree upon the principle that where the effect of the tax upon the state is regarded as immediate and direct there is immunity; where it is regarded as remote and indirect there is none. Illustrative cases discussing the principle and assembling the authorities are: Helvering vs. Powers, 293 U. S. 214; Burnot vs. Jergins, 288 U. S. 501; Metcalf & Eddy vs. Administratix, 269 U. S. 514; Register vs. Commissioner, 69 F. (2d) 607; Fox Film Corp. vs. Doyal, 286 U. S. 123; Liggett & Meyers vs. U. S. — U. S. —, decided January 4, 1937.

I think the Board rightly denied the exemption. Their decision and order should stand. I dissent from the reversal.

Judgment

Extract from the Minutes of March 9th, 1937

No. 8212

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL

vs.

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of John H. Therrell, also known as J. H. Therrell, for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, it is now here ordered, adjudged and decreed by this court, that the judgment of the said United States Board of Tax Appeals in this cause be, and the same is hereby, reversed, with direction to eliminate the contested tax.

Hutcheson, Circuit Judge, dissenting.

Clerk's certificate

United States of America

United States Circuit Court of Appeals, Fifth Circuit

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 60 to 70 next preceding this certificate contain full, true, and complete copies of all the pleadings, record entries, and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 8212, wherein John H. Therrell, also known as J. H. Therrell is petitioner, and Commissioner of Internal Revenue is respondent, as full, true, and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 59 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 24th day of May A. D. 1937.

[SEAL]

OAKLEY F. DODD,
Clerk of the United States Circuit Court of Appeals, Fifth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1937

Order following certiorari

Filed October 11, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice BLACK took no part in the consideration and decision of this application.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit, entered in the above cause on March 9, 1937, reversing the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 49–52) is a memorandum opinion which is not reported. The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported in 88 F. (2d) 869.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 9, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts received by the respondent as compensation for services as liquidator of certain State banks, paid entirely out of funds of the banks, are immune from Federal taxation.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations will be found in the Appendix, *infra,* pp. 8–14.

STATEMENT

The facts in this case as alleged and admitted and as stated in the opinion of the Board of Tax Appeals (R. 49–52) may be summarized as follows: In July 1930 the respondent was appointed by the Comptroller of the State of Florida as liquidator of the Bank of Bay Biscayne, a State banking institution of the State of Florida located at Miami, Florida. Later he was appointed liquidator for other banking institutions. (R. 5–6, 48, 49–50.) The appointment of liquidators to administer insolvent banking institutions by the Comptroller of the State is authorized by the Laws of Florida, Section 19, Chapter 13576 (1929), or 4162

Revised General Statutes, 6102 Compiled General Laws. (R. 50.)

The respondent, in assuming his duties as liquidator, received no commission from the Governor of the State and took no oath of office. He was appointed by and served entirely at the pleasure of the Comptroller. He was required to give bonds in each of the undertakings. R. 50.)

As liquidator, the respondent's duties were to handle litigation involving the liquidating banks and to dispose of their assets to the best advantage of the depositors and others concerned. He exercised supervision over a number of persons employed in various capacities to assist in the liquidation of the several banks, and was himself under the supervision of the Comptroller. He devoted all of his time to his duties of liquidator in both the years 1931 and 1932 except on occasions when he attended directors' meetings of a bank at Ocala, Florida, of which he was still president in an inactive status. The bank at Ocala paid the cost of his transportation to and from directors' meetings. (R. 50.)

The amount of the respondent's compensation for services in liquidating the several institutions was fixed by the Comptroller on a commission basis not in excess of five percent of the amounts collected by him and turned over to the State, and was paid out of the moneys recovered by him in the liquidation of the various banking institutions. His total compensation amounted to $8,555.61 in

1931 and $39,448.07 in 1932. (R. 50–51.) The respondent, contending that the amounts were received as an employee or officer of the State of Florida, claimed exemption from Federal income tax thereon. The Commissioner of Internal Revenue held that the compensation was taxable income and the respondent appealed to the United States Board of Tax Appeals. The Board of Tax Appeals sustained the Commissioner. From such action the respondent sought review by the United States Circuit Court of Appeals for the Fifth Circuit. That court reversed the decision of the Board of Tax Appeals, one judge dissenting.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the respondent as liquidator was not subject to Federal income taxation.

2. In failing to hold that the respondent was neither an officer, an employee, nor an agent of the State engaged in an essential governmental function.

3. In failing to hold that, even if the respondent were an officer, an employee, or an agent of the State, taxation of the compensation received by him out of funds of the insolvent banks imposes no prohibited burden upon the State.

REASONS FOR GRANTING THE WRIT

1. The decision in the instant case is in direct conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *McLoughlin* v.

Commissioner, decided May 3, 1937, not yet reported but found in 1937 C. C. H., Vol. 4, page 9907, affirming 34 B. T. A. 963, and in substantial conflict with *Miller* v. *McCaughn,* 27 F. (2d) 128 (C. C. A. 3d). In the *McLoughlin* case, *supra,* the State of New York engaged the services of an attorney to assist in the liquidation of insurance companies. The compensation for the services rendered in that case was, as here, paid out of funds of the companies liquidated. The court held that the rule of immunity had no application in that case because no burden was imposed upon the State. In that case the court, speaking of the present case, said:

> Any distinction between the Therrell decision and the case at bar is tenuous but, with all respect, we feel obliged to differ with the decision of the majority.

In the case of *Miller* v. *McCaughn, supra,* it was held that the rule of immunity did not apply to preclude income tax upon compensation paid to an examiner, appointed by a State court, out of funds paid to the clerk of the court by surety companies upon whose financial resources the examiner reported.

The precise question here has never been passed upon by this Court, but in numerous cases not involving officers or employees of a State or of a political subdivision thereof this Court has held that the rule of immunity did not apply unless it was established that the Federal tax involved im-

posed a real and substantial burden upon the State. *Willcuts* v. *Bunn*, 282 U. S. 216; *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279; *Educational Films Corp.* v. *Ward*, 282 U. S. 379; *Fox Film Corp.* v. *Doyal*, 286 U. S. 123; *Burnet* v. *A. T. Jergins Trust*, 288 U. S. 508; *Trinityfarm Co.* v. *Grosjean*, 291 U. S. 466. See also *Snyder* v. *Bettman*, 190 U. S. 249; *Greiner* v. *Lewellyn*, 258 U. S. 384; *South Carolina* v. *United States*, 199 U. S. 437; *Ohio* v. *Helvering*, 292 U. S. 360; *Helvering* v. *Powers*, 293 U. S. 214.

The court below gave no weight to the fact that the compensation was paid out of funds which were not State funds and which would not otherwise inure to the State.

2. The question in this case is of current administrative importance. In six other cases decided by the Board of Tax Appeals[1] the rule of immunity has been held not to apply under facts similar to those in the instant case involving the liquidation of banks or insurance companies. In *Saxe* v. *Anderson*, decided by the District Court for the Southern District of New York on March 26, 1937, not yet reported but found in 1937 C. C. H., Vol. 4,

[1] *Davie* v. *Commissioner*, 26 B. T. A. 1007; *Spangler* v. *Commissioner*, B. T. A. Docket No. 46386, decided by memorandum opinion April 5, 1933; *Robeerts* v. *Commissioner*, B. T. A. Docket No. 74214, decided by memorandum opinion October 31, 1934; *McLoughlin* v. *Commissioner*, 34 B. T. A. 963, affirmed by the Circuit Court of Appeals for the Second Circuit, *supra*; *Freedman* v. *Commissioner*, 34 B. T. A. 956, and *Hanrahan* v. *Commissioner*, B. T. A. Docket No. 83071, decided by memorandum opinion November 12, 1936.

p. 9684, the same principle was applied. The question is now pending before the Circuit Court of Appeals for the Third Circuit in the case of *Freedman* v. *Commissioner*, 34 B. T. A. 956, and in the Circuit Court of Appeals for the Sixth Circuit in the case of *Hanrahan* v. *Commissioner*, B. T. A. Docket No. 84071, decided by memorandum opinion November 12, 1936. A related question is now pending before the Circuit Court of Appeals for the Second Circuit in the case of *Harman* v. *Commissioner*, argued before and submitted to that court on May 20, 1937.

3. On June 1, 1937, the Court assigned for reargument the cases of *James* v. *Dravo Contracting Co.*, No. 625, October Term, 1936; *Silas Mason Co.* v. *Tax Commissioner*, No. 773, October Term, 1936, and *Ryan* v. *State of Washington*, No. 774, October Term, 1936, and requested the Attorney General to present the views of the Government upon the question, *inter alia*, of whether the State taxes impose a burden upon the Government. The question here presented is closely related and the pendency of those cases is an added reason for granting the writ here.

CONCLUSION

It is in the public interest that the conflict here presented be resolved by an authoritative decision. Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

JUNE 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> (a) General definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
>
> * * * * *

Revenue Act of 1932, c. 209, 47 Stat. 169:

> [Sec. 22 (a), insofar as here pertinent, is substantially the same as Sec. 22 (a) above quoted.]

General Laws of Florida (1929), Vol. 1, ch. 13576:

> SECTION 19. That Section 4162 of the Revised General Statutes of the State of Florida be amended so as to read as follows:
>
> SECTION 4162. COMPTROLLER MAY APPOINT LIQUIDATOR; DUTIES OF LIQUIDATOR; NOTICE TO BANK OFFICERS; CONFIRMING APPOINTMENT. On becoming satisfied, from the reports furnished to him by a State Bank Examiner, or upon other satisfactory evidence thereof, that any bank, banking firm, banker, banking or trust company, or corporation

doing business in this State under the State laws, has become insolvent and is in default, or that the affairs of any bank, banker, banking firm or trust company or corporation doing business in this State, under such State laws, is in an unsound condition, or threatened with insolvency because of illegal or unsafe investments, or that its liabilities exceed its assets, or that it is transacting business without authority of law or in violation of law, or if the directors of any bank, banking or trust company, or corporation, or any banker or the management of any banking firm doing business in this State under the State laws, shall knowingly violate, or knowingly permit any of its officers, agents or servants to violate any of the provisions of law relative to such bank, bankers, banking firms, banking or trust companies, or corporations doing business in this State, the rights, privileges and franchises shall be subject to be forfeited, and the State Comptroller may in his discretion forthwith designate and appoint a liquidator to take charge of the assets and affairs of such bank, and require of him such bond and security as the Comptroller deems proper, not exceeding double the amount that may come into his hands, and such liquidator shall be subject to dismissal by the Comptroller, whenever in his judgment such dismissal is deemed necessary or advisable; when one liquidator is dismissed, another may be duly designated and appointed. Such liquidator under the direction and supervision of the Comptroller shall take possession of the books, records and assets of every description of such bank, banker, banking firm, banking and trust company, or corporation, and in his name shall sue for and collect all debts, dues and claims belonging to it, and

upon the order of a court of competent jurisdiction may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such bank, banker, banking firm, banking and trust company, or corporation, on such terms as the court shall direct; and may, if necessary, to pay the debts of such bank, banker, banking firm, banking and trust company, or corporation, sue for and enforce the individual liability of the stockholders. Such liquidator shall pay all money received by him to the State Treasurer to be held as a special deposit for the use and benefit of the creditors, subject to the order of the Comptroller, and shall also make quarterly reports to or when called upon, to the Comptroller of all of his acts and proceedings. The Comptroller, immediately upon appointing such liquidator, shall serve notice upon the president, or upon any vice-president or cashier, or upon any director or other person having the charge or management of any such bank, banker, banking firm, banking or trust company, or corporation, informing him or them in such notice of his action in appointing such liquidator; and notifying him or them or it that he would apply on a date therein named, not to exceed ten days from the date of service of such notice, to some circuit judge having jurisdiction over the same, for an order confirming his action and the appointment of a liquidator for such banking institution and such bank, banking firm, or banking or trust company, or corporation may, at such hearing contest before such circuit judge the rightfulness and legality of such action of the Comptroller in appointing such liquidator.

SECTION 20. The Comptroller may provide for the administration of the affairs of

institutions under the above section by one general liquidator who shall be designated by the Comptroller as a General Liquidator for the administration of the affairs of several or all of the instructions in liquidation, whose compensation shall be paid by the Comptroller, to be paid in such proportions out of the assets of the institution whose affairs are being administered as the Comptroller may determine, not exceeding in the aggregate Six Thousand ($6,000.00) Dollars per annum. The Comptroller may provide for the transfer at any time to the general liquidator of the affairs of any institution for which a particular liquidator or receiver has been heretofore or shall hereafter be designated and the general liquidator shall be thereupon vested with all the rights conferred by law on such general liquidator as if he had been designated in the first instant to act as such.

SECTION 21. That Section 4164 of the Revised General Statutes of the State of Florida be amended so as to read as follows:

SECTION 4164. EXPENSES OF LIQUIDATING AGENT OR AGENTS; COMPENSATION OF LIQUIDATORS; DEPOSITION OF BANK'S FUNDS. All expenses of any liquidator shall be paid out of the assets of such bank, banker, banking firm, banking or trust company, or corporation before distribution of the proceeds thereof. The compensation of the liquidator shall be fixed by the Comptroller, and shall be based upon the amount of work actually necessary and performed, and shall in no case exceed five per cent of the cash collections. From time to time, after full provisions having first been made for the expenses of the liquidating agency, and the payment of liens for taxes and preferred claims, the Comptroller shall make ratable

dividend of the money in the hands of the State Treasurer on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and as the proceeds of the assets of such bank, banker, banking firm, banking or trust company, or corporation, are paid over to the liquidator, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, after all claims have been paid, shall be paid over to the shareholders, of such bank, banker, banking firm, banking or trust company, or corporation, or their legal representatives in proportion to the stock by them respectively held, or their interest therein as appearing.

SECTION 22. That Section 4165 of the Revised General Statutes of the State of Florida be amended so as to read as follows:

SECTION 4165. COMPTROLLER MAY PURCHASE PROPERTY TO PROTECT LIQUIDATOR'S TRUST. Whenever any liquidator, duly appointed by the Comptroller, and who shall have qualified and entered upon the discharge of his trust, shall find it in his opinion necessary to fully protect and benefit his said trust, to the extent that said trust may have in any property, real or personal, by reason of any bond, mortgage, lien, assignment, equity or other proper legal claim attaching thereto, and which said property is to be sold under execution, decree or foreclosure, or any proper order of any court of competent jurisdiction, or reclaimed or repossessed by any person having title opposed to such equity of his trust, he may certify the facts in the case, together with his opinion as to the value of the property, and the value of the equity his trust may have in same, and the amount that may be

necessary to purchase such property, to the Comptroller, and if the Comptroller shall in his judgment deem it to the best interest of the said trust, he shall be and is empowered to draw upon the funds to the credit of said trust in the hands of the State Treasurer to the amount necessary for the purchase of said property for the said trust.

Treasury Regulations 74:

ART. 56. *State contracts.*—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. * * *

ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are subject to tax for 1928 and subsequent taxable years.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplish-

ment of specific objects, and whose services are continuous, not occasional or temporary. * * *

Treasury Regulations 77:

[Art. 56 and Art. 643 are identical with the corresponding articles of Treasury Regulations 74 quoted above.]

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 128

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 49–52) is not reported. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 61–64) is reported in 88 F. (2d) 869.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 9, 1937. (R. 66.) Petition for

certiorari was filed June 9, 1937, and was granted October 11, 1937. (R. 67.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts received by the respondent as compensation for services rendered as liquidator of certain Florida State banks and paid entirely out of funds of the banks are immune from Federal taxation on the ground that such a tax would be an unconstitutional burden upon the State.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix A, *infra*, pp. 47–54.

STATEMENT

The essential facts as they appear from the pleadings and as stated in the opinion of the Board of Tax Appeals (R. 49–52) may be summarized as follows:

In July, 1930, the respondent was appointed, by the Comptroller of the State of Florida, liquidator of the Bank of Bay Biscayne, a state banking institution of the State of Florida, located at Miami, Florida (R. 19–20), and duly qualified as such liquidator (R. 20–25).

The respondent thereafter, in the years 1930 and 1931, was appointed liquidator for other banking

institutions within the State of Florida and duly qualified as such. (R. 25–47, 50.) The appointment of liquidators to administer insolvent banking institutions by the Comptroller of the State of Florida is authorized by the laws of Florida. (Florida Laws, 1929, Vol. I, c. 13576, Sec. 19, amending Sec. 4162, Revised General Statutes.) (R. 50.)

The respondent, in assuming his duties as liquidator, received no commission from the government of the State of Florida and took no oath of office. He was appointed by and served entirely at the pleasure of the Comptroller and was required to give bonds in each of his undertakings as liquidator. (R. 50.)

The respondent's duties as liquidator were to handle litigation involving the liquidation of the banks and to dispose of their assets to the best advantage of depositors and others concerned. As liquidator the respondent exercised supervision over a number of persons employed in various capacities to assist in the liquidation of the several banks, and was, himself, under the direct supervision of the Comptroller. During the years 1931 and 1932 the respondent devoted all of his time to his duties as liquidator except on occasions when, as inactive president of a bank at Ocala, Florida, he attended directors' meetings. (R. 50.)

The respondent's compensation for his services in liquidating the several banking institutions was

determined and paid to him by the Comptroller on a commission basis, not in excess of 5% of the amounts collected by him and turned in to the State Treasury, and was paid out of the moneys recovered by him in the liquidation of the various banking institutions. (R. 50, 52.) Sections 4162, 4164, Revised General Statutes, *infra,* pp. 48–52. The respondent's compensation as liquidator of the several banking institutions amounted to $8,555.61 in 1931 and $39,448.07 in 1932. (R. 51.)

The respondent, contending that these amounts were received by him as an employee or officer of the State of Florida, claimed an exemption from Federal income tax. The Commissioner of Internal Revenue held that the compensation was taxable income and determined the deficiencies here in issue in the amounts of $108.78 and $6,329.53, for the years 1931 and 1932, respectively. (R. 49, 52.) The Board of Tax Appeals held (R. 52) that the respondent was neither an officer nor an employee of the State of Florida and that his only relation to that State was a contractual relation by which he was to furnish service and that the imposition of a Federal income tax on his compensation received on a percentage basis out of moneys recovered by him as liquidator of closed banks could not be deemed to be an interference with the governmental functions of the State of Florida, or to place a prohibited burden upon the State of Florida in the exercise of its governmental func-

tions, and determined the deficiencies in respondent's income taxes for the years 1931 and 1932, which are in issue here. (R. 53.)

The Circuit Court of Appeals, one judge dissenting, reversed the decision of the Board of Tax Appeals.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the respondent as liquidator was not subject to Federal income taxation.

2. In failing to hold that the respondent was neither an officer, an employee, nor an agent of the State engaged in an essential governmental function.

3. In failing to hold that, even if the respondent were an officer, an employee, or an agent of the State, taxation of the compensation received by him out of funds of the insolvent banks imposes no prohibited burden upon the State.

SUMMARY OF ARGUMENT

The only question in this case relates to the application of the constitutional principle that a Federal tax upon an individual is invalid if it threatens to destroy the dual system of government. It is unnecessary in this case to question the principle of *Collector* v. *Day,* 11 Wall. 113, since even if that principle be accepted the Com-

missioner's determination may be sustained upon any of three separate grounds.

I

The services of the respondent were not rendered in connection with an essential governmental function. His duties were not those of regulating state banking institutions, but consisted in liquidating certain insolvent banks and trust companies. Florida statutes subject liquidators, just as solvent banks, to supervision by the regular bank examiners. The purpose of the liquidation is not to insure sound banking practices generally, but to benefit the particular individuals who were creditors and stockholders in the closed banks. The liquidator has no regulatory functions and his activities consist only of those which are found in the operation of a solvent bank.

As was the case in *Helvering* v. *Powers,* 293 U. S. 214, the respondent was conducting a private enterprise, was paid out of private assets, and was engaged in an activity essentially different from the regulation of the going concern. In this case, as in that, the controlling principle must be that which forbids the State from withdrawing normal sources of Federal revenues by itself conducting the business.

The fact that 32 states permit the Federal Deposit Insurance Corporation to serve as a liquidator of insolvent state banks seems conclusive that

the function is not one essential to the independence of the states from the central government.

II

The respondent's compensation was paid out of the assets of the insolvent bank, and not out of the State treasury. It seems necessarily to follow that a tax upon this compensation cannot possibly be an unconstitutional interference with the State. Such was the unequivocal decision in *Flint* v. *Stone-Tracy Co.*, 220 U. S. 107, 174. While the lower courts are in conflict, it seems to us to be abundantly plain that a tax upon compensation from private funds is wholly irrelevant to the finances of the State. And if the tax be imposed upon an individual, and if it cannot affect the State treasury, *ex hypothesi*, it is impossible for it to be an interference with the functions of the State. It is to be noted that our argument does not here go to the point of urging the validity of a tax upon officials whose compensation is derived from fees collected for the State; these fees are government revenues, while the assets of an insolvent bank are not.

This Court has often pointed out that the doctrine of tax exemption must be limited to the necessity of protecting our dual system of government. *Helvering* v. *Powers, supra*, pp. 224–225, *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523. To grant tax exemption to individuals who are not

paid out of public funds would be extending the doctrine far beyond its necessity and would have alarming consequences upon the Federal revenues. See *Willcuts* v. *Bunn*, 282 U. S. 216, 225; *Susquehanna Co.* v. *State Tax Commission* (*No. 1*), 283 U. S. 291, 294.

III

The respondent was neither an officer nor an employee of the state. He took no oath of office and received no commission. The Board found that he was neither an officer nor an employee. The Florida statutes require that the regular bank examiners supervise not only banks but also their liquidators; this is inconsistent with viewing a liquidator himself as another employee of the Comptroller. The respondent was appointed for a particular job. He was paid by the job, in a fluctuating amount which was greater than the Comptroller's salary. He continued his private connections with the private banking business. His qualifications were such that the supervision of the Comptroller was probably nominal. Certainly, in view of the findings of the Board of Tax Appeals, the supervision must be taken to have been consistent with the status of a contractor, rather than that of an employee.

ARGUMENT

This case presents the question whether the Federal Government may constitutionally impose a tax

upon the compensation of the respondent as liquidator of certain insolvent Florida banks and trust companies, paid entirely out of the assets of the liquidating banks and trust companies. In *James* v. *Dravo Contracting Co.*, *Mason* v. *Tax Commission, and Ryan* v. *Washington,* Nos. 3, 7 and 8, this Term, the Government raised the question whether any non-discriminatory tax could be considered a threat to our dual system of government, when applied to a private person whose only claim of immunity rested on the fact that he dealt with the Government. In the oral argument of that case the Government suggested that the application of that principle to officers and employees of the respective governments turns upon the decision of this Court as to the importance to the independence of the state and central governments that their employees be exempt from taxes upon their salaries. In the three cases then under consideration the Government took the position that reexamination of the cases such as *Collector* v. *Day,* 11 Wall. 113, was there unnecessary.

Similarly, we are of the view that the present case is not such that we should ask for a reexamination of the cases which hold or assume that preservation of our dual system of government requires that the employees or officers of the central and state governments be exempted from a nondiscriminatory tax imposed by the other sovereign. This is the case, we submit, because: (1) the liqui-

dation of insolvent banks is not an essential governmental function; (2) the doctrine of a constitutional exemption from taxation because of the immunity of the sovereign can have no application to compensation paid from private funds; and (3) the respondent is not an officer or employee of the State. Any one of these conclusions is sufficient to sustain the Commissioner's determination.

Before discussing these propositions, it should be observed that the question before the Court is solely one of the application of a constitutional principle. The earlier Revenue Acts exempted the "compensation of all officers and employees of a state or any political subdivision thereof." (Sec. II (b), c. 16, 38 Stat. 114; Sec. 4, c. 463, 39 Stat. 756; Sec. 201 (a), c. 63, 40 Stat. 300.) However, since the Revenue Act of 1918 there has been no comparable provision, Congress having left "the constitutional question as to the authority of Congress to tax certain salaries to be settled by the courts * * *." (S. Rep. No. 617, 65th Cong., 3d Sess., Pt. 1, p. 6.) While Sections 22 of the Revenue Acts of 1928 and 1932, here involved, contain no exemption of government salaries, Articles 643 of Treasury Regulations 74 and 77, *infra*, recognize the principle of constitutional immunity and exempt "compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function

* * *." Our argument does not go beyond the Regulation, as we interpret it, but if it should be construed to exempt compensation paid out of private funds, we then submit that it is invalid. The Treasury Department cannot "either limit the provisions of the statute or define the boundaries of their constitutional application." *Helvering* v. *Powers,* 293 U. S. 214, 224.

I

THE SERVICES OF RESPONDENT WERE NOT IN CONNECTION WITH AN ESSENTIAL GOVERNMENTAL FUNCTION

Whether or not respondent is an officer or employee of the State, and even though his compensation were derived from State funds, the payments are subject to federal taxation because his services were not rendered in connection with an essential governmental function.

It is settled that there can be no claim of immunity unless the compensation be given for services performed for the State in connection with activities of a nature such that Federal taxation would violate "the necessary protection of the independence of the national and state governments within their respective spheres." *Helvering* v. *Powers,* 293 U. S. 214, 225; see *South Carolina* v. *United States,* 199 U. S. 437; *Ohio* v. *Helvering,* 292 U. S. 360, 368–369. The question for decision is whether the liquidation of financial institutions

by the states is such an essential governmental function.

The discussion will, we believe, be clarified if the issues be narrowed at the outset. The Government concedes that the *regulation* of the state banking institutions is an essential governmental function. We anticipate that respondents will not argue that the *operation* of state financial institutions is an essential governmental function, or deny that a state-owned bank, and its employees, would be subject to Federal taxation. Such, at any rate, was the decision in *State of North Dakota* v. *Olson,* 33 F. (2d) 848 (C. C. A. 8th), appeal dismissed for want of jurisdiction, 280 U. S. 528, and such are the plain implications of *South Carolina* v. *United States, Ohio* v. *Helvering,* and *Helvering* v. *Powers,* all *supra.* Further, we have no doubt but that the State has an important public interest in the orderly liquidation of its financial institutions; each of the states has made statutory provision for a special method of administrative liquidation of these institutions.[1] In our view of the case, the question is thus reduced to the inquiry as to whether liquidation of financial institutions, admittedly within the "zone of debatable ground" (*Brush* v. *Commissioner,* 300 U. S. 352, 365), is

[1] In Appendix B, *infra*, p. 55, we have made a rough classification of the types of machinery provided for the relief or liquidation of insolvent financial institutions by each of the states.

more akin to the operation or to the regulation of the state financial institutions.[2]

The answer given by the Florida statutes seems relatively clear. Section 4159 of the Revised General Statutes, as amended, *infra,* authorizes the Comptroller to appoint a bank report analyst and examiners to examine into the affairs of banks and their liquidators. Section 4161, *infra,* requires that banks and liquidators be examined at least twice a year.[3] It is improbable that the liquidator would be subject to the State regulatory machinery unless he were viewed as substantially similar to the operating bank.

The expenses of liquidation are paid out of the assets and income of the insolvent institution, rather than by the appropriation of public funds out of the state treasury (see *infra,* pp. 21–35). This seems more akin to the conduct of a particular business enterprise than to state regulation.

The purpose of liquidation is to return to the creditors and shareholders as much of their depos-

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[2] The characterization, in *Relfe* v. *Rundle*, 103 U. S. 222, 225, of the statutory successor of an insurance company was: "He is an officer of the State, and as such represents the State in its sovereignty while performing its public duties connected with the winding up of the affairs of one of its insolvent and dissolved corporations." This was directed toward an entirely different question, his succession to foreign assets, and has no application here.

[3] Apparently, however, an examination fee is not charged the liquidator.

its, loans and investments as possible (see Secs. 4162, 4164, *infra*). The undoubted public interest in securing the largest feasible return, leading in turn to the establishment of expert, administrative liquidation proceedings, does not alter the fact that the activity is being undertaken not to insure sound banking practices generally, but to benefit the individuals who are interested in the affairs of a particular institution. The liquidator's efforts, just as those of the officials of a solvent bank, are directed exclusively toward the benefit of those concerned with the operations of the single bank.

None of the liquidator's activities are regulatory in nature. The actual activities of the liquidator consist chiefly of the sale of assets and the collection of loans, in order to realize cash assets. The activities of a solvent bank include these and, in addition, making loans and investments and receiving deposits. The liquidator, accordingly, does a part of the business of a solvent bank. A reduction in the scope of the activities, without any change in their nature, obviously does not convert a business enterprise into one which is regulatory in character.

If there were doubt, it would seem removed by the decision of this Court in *Helvering* v. *Powers*, 293 U. S. 214. The facts here are strikingly similar to those there considered. Powers was trustee of the Boston Elevated Railway Company. There, as here, the enterprise was one such that its *regulation*

was an essential governmental function. There, as here, the public interest suggested government operation when the affairs of the private enterprise became deranged. It can make no difference that in the *Powers* case the government leased the property for a temporary period while here it took control for the purpose of liquidation; in each case the property was privately owned and the government management was for the benefit of the creditors and shareholders of the enterprise. Indeed, the important and general governmental interest in the maintenance of low fares made operation of the Elevated Railway much more "public" in nature than in the case of the insolvent bank. In the *Powers* case, as here, the property of the enterprise remained subject to state taxation.[4] In the *Powers* case, as here, the enterprise was subject to Federal taxation before it was taken over by the State. Accordingly, we think the decision in the *Powers* case conclusive of the issue here presented. There the Court said (p. 225):

> The principle of immunity thus has inherent limitations. * * * And one of these limitations is that the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by

[4] We assume that the absence of exemption in the Florida statutes means that the property held by the liquidator remains subject to taxation.

> reason of their nature, the federal taxing power would normally extend. The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity. * * *

Finally, the Court in the *Powers* case (p. 227) brushed aside the argument that a temporary operation was more of a governmental function than would be outright ownership and a continuing government operation. That conclusion is equally applicable here.

This Court has already indicated the fallacy which underlies the reasoning of the court below. The majority said (R. 64):

> We are of opinion that the establishment and supervision and orderly winding up of State banks is a true governmental function of the State, resting not only on its fiscal needs and powers but also on its police power.

In other words, from "establishment and supervision" the majority made an effortless leap to the quite different matter of "orderly winding up." This, as we have shown, is more akin to operation than to regulation. And in *Ohio* v. *Helvering*, 292 U. S. 360, 369, this Court said: "the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on."

See also *South Carolina* v. *United States*, 199 U. S. 437, 457–458; *United States* v. *California*, 297 U. S. 175.

In both the *South Carolina* and the *Powers* cases the Court has not only considered the effect on Federal revenues, but has apparently made this the basis of its decision as to the asserted governmental character of the activity. In *South Carolina* v. *United States*, *supra*, p. 455, the Court summarized its earlier analysis by saying: "Indeed, if all the States should concur in exercising their powers to the full extent, it would be almost impossible for the Nation to collect any revenues." And in *Helvering* v. *Powers*, *supra*, p. 225, the Court defined a limitation upon the doctrine of intergovernmental tax immunity as the principle that "the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the federal taxing power would normally extend." See also *United States* v. *California*, *supra*, p. 184.

Here, the state bank [illegible] its employees were fully subject to Federal taxation while the institution was solvent. They would remain subject to taxation during the period of liquidation had the stockholders voted to liquidate and dissolve. Under the settled doctrine of the *South Carolina* and *Powers* cases, the fact that the State chooses itself to op-

erate or liquidate the institution cannot take this usual source of revenue out of the reach of the Federal Government.

Brush v. *Commissioner*, 300 U. S. 352, has no application to the circumstances of this case. There the activity of supplying water was such that, had it been abandoned, "in a very real sense * * * the city itself would then disappear." The maintenance of a water supply was held to be a "necessary auxiliary" of essential governmental activities. (P. 371.) Such is not the case here. The State of Florida would continue to exist without substantial change whether or not a State official undertook the liquidation of insolvent banks. Indeed, even its regulation of active banks would be substantially unaffected.

Finally, we urge that the liquidation of insolvent banks cannot be an essential governmental activity, such that the maintenance of our dual system of government requires freedom even from taxation of the employees, because many states permit or require the activity to be undertaken by the Federal Government itself. The majority of the states have made provision for the appointment of the Federal Deposit Insurance Corporation as receiver or liquidator of an insolvent state bank the deposits of which are insured with the Corporation. In two States the provision is mandatory.* In twenty-five

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*Louisiana Laws of 1934, Act No. 180, Sec. 4; Mississippi, Banking Code of 1936, Sec. 112.

States (including Florida) the appointment of the Corporation is permissive.[6] In five States the pre-existing statutes[7] have received informal administrative construction to authorize the Corporation to serve as receiver, liquidator or agent of the state officials.

The Federal Deposit Insurance Corporation is a federal instrumentality, the capital stock of which was subscribed by the United States, the Federal Reserve Banks and the members of the Corporation (Sec. 8, c. 89, 48 Stat. 162, 168–169). We are unable to see how the function of liquidating state

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[6] Alabama, Laws of 1935, Act. No. 395, Sec. 3; Arkansas, Laws of 1933, Act No. 15, Sec. 1 (as construed); California, Laws of 1935, ch. 501, Sec. 2; Colorado, Laws of 1937, ch. 100, Sec. 3; Florida, Laws of 1937, Act No. 7, Sec. 1; Idaho, Laws of 1935, ch. 9, Sec. 3; Kansas, Laws of 1937, ch. 76, Sec. 3; Michigan, "New Banking Code" of 1937, S. B. No. 2, Sec. 125; Minnesota, Laws of 1937, ch. 404, Sec. 3; Montana, Laws of 1937, S. B. No. 81, Sec. 3; Nebraska, Banking Code of 1935, ch. 8, Sec. 3; Nevada, Laws of 1935, ch. 87, Sec. 3; New Mexico, Laws of 1935, ch. 16, Sec. 3; North Carolina, Laws of 1935, ch. 81, Sec. 4; North Dakota, Laws of 1935, ch. 95, Sec. 3; Ohio, Banking Code of 1937, Sec. 710–89d; Oklahoma, Laws of 1935, p. 197, Sec. 3; South Carolina, Laws of 1935, Act No. 339, Sec. 3; South Dakota, Laws of 1935, ch. 60, Sec. 1; Tennessee, Laws of 1935 (Ex.), ch. 42, Sec. 2; Texas, Laws of 1935, ch. 183, Sec. 3; Utah, Laws of 1935, ch. 8, Sec. 3; Vermont, Laws of 1935, Act No. 173, Sec. 1; West Virginia, Laws of 1935, ch. 17, Sec. 3; Wisconsin, Laws of 1935, ch. 469, Sec. 220.081, amended by laws of 1937, ch. 284.

[7] Illinois, Jones' Ill. Stats., vol. 3, Sec. 10.11; Kentucky, Carroll's Statutes, Sec. 165a–17; Maine, Revised Statutes, 1930, ch. 57, Sec. 52; Pennsylvania, Purdon's Stats., Tit. 7, Sec. 482; Washington, Remington's Revised Statutes, Sec. 3269.

banks could be extended to a Federal instrumentality by 32 States (including Florida) and yet be an activity which must be exempted from Federal taxation because such a protection is necessary to the independence of the state governments. Compare *Helvering* v. *Powers, supra,* p. 225; *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575; *Ambrosini* v. *United States,* 187 U. S. 1, 7; *Collector* v. *Day,* 11 Wall. 113, 125, 127. It is evident that at least 32 of the States do not feel that their sovereignty, or their independence in our dual system, is impaired if they allow the Federal Government actually to undertake the liquidation of state banks in place of the State. *A fortiori,* this activity is not an activity so essential to the governmental powers of the State that the Federal Government should be held unable even to tax the compensation of those engaged in performing it.

Any decision to the contrary would present the most perplexing problems. The Federal Deposit Insurance Corporation, we are informed, is actually liquidating, or acting as a receiver for, insolvent state banks in eight States.[8] It would be difficult for the Federal Government to tax the compensation paid those engaged in this activity if this Court were to hold the tax immunity of the activity essential to the independence of the state governments. Yet a decision that the Federal Govern-

[8] North Dakota, South Dakota, Oklahoma, Mississippi, Louisiana, West Virginia, Ohio, and Michigan.

ment could not tax its own employees because this would threaten the independence of the state governments is incomprehensible. In our view, the only solution to this dilemma is the common sense suggestion that, if the states generally delegate the task to the Federal Government, the activity cannot be essential to their independent sovereignty.

II

A TAX ON COMPENSATION PAID FROM PRIVATE FUNDS CONTAINS NO THREAT TO THE DUAL SYSTEM OF GOVERNMENT

1. The respondent's compensation was fixed by the Comptroller of the State, although it was not to exceed five percent of the cash collections. But the Florida statute expressly provides that the respondent's compensation should be "paid out of the assets of such bank, banker, banking firm, banking or trust company, or corporation" (Sec. 4164, Revised General Statutes, as amended, *infra*) of which the respondent was liquidator. The payment of the respondent's compensation was made by the Comptroller out of moneys held by the State Treasurer "as a special deposit for the use and benefit of the creditors" of each particular insolvent bank or trust company for which the respondent was appointed as liquidator (Sec. 4162, Revised General Statutes, as amended, *infra*).

It results that respondent's compensation was not paid out of State funds. It came out of the

income or assets of the insolvent bank. Whether the compensation was large or small in no manner affected the State finances. There is no substantial difference, so far as the interest of the State is concerned, between the compensation paid respondent and that paid the bank president prior to the insolvency. The mechanics of the payment differ, it is true, in that the respondent was paid by an order drawn by the Comptroller on the fund held by the State Treasurer, while the bank president was probably paid by an order on the bank drawn by the cashier. In addition, it is recognized that the Comptroller supervised the liquidator in a somewhat different manner than he did the going concern (see, however, Section 4159 of the Revised General Statutes, *infra*). But these circumstances do not change the obvious fact that in each case the directing official receives his compensation not from the State but from the assets and income of the bank.

2. We have, then, a case in which there can be no contention that the tax here involved would in any manner affect the finances of the State. The respondent bases his whole claim to immunity on the fact that he was appointed by and served under a State official. The question is whether, even assuming respondent to be an officer or employee of the State whose services were in connection with the performance of an essential governmental function, he may claim the protection of the State's

sovereign immunity from Federal taxation when his compensation is taken wholly from private funds.

In our view this Court has unequivocally settled this question. In *Smith* v. *Northern Trust Co.*, argued with *Flint* v. *Stone-Tracy Co.*, 220 U. S. 107, the stockholder's bill alleged that the Trust Company (No. 411, 1910 Term, R. 6) "receives a considerable and valuable income from its frequent appointment by the courts of Illinois as trustee, receiver, assignee, guardian, conservator, executor or administrator". From this it was argued that the Congress was without constitutional power to impose such a tax. This Court rejected the argument, and said (p. 174):

> Nor is the special objection tenable, made in some of the cases, that the corporations act as trustees, guardians, etc., under the authority of the laws or courts of the State. Such trustees are not the agents of the state government in a sense which exempts them from taxation because executing the necessary governmental powers of the State. The trustees receive their compensation from the interests served, and not from the public revenues of the State.

Again, in *Helvering* v. *Powers*, 293 U. S. 214, 223, the Court gave some emphasis to the fact that the taxpayer's compensation was derived from the Elevated Railway rather than from the State.

Notwithstanding the unequivocal declaration of this Court in *Flint* v. *Stone-Tracy Co.*, the rulings

of the lower courts and of the administrative officials are conflicting. The majority of the court below thought, because the payments were controlled by the Comptroller rather than the bank or its creditors, that "it is superficial to say that they pay him." (R. 62). It followed this decision in *Tunnicliffe* v. *Commissioner*, 88 F. (2d) 873, pending in this Court, No. 129. The Circuit Court of Appeals for the Sixth Circuit, in *Bettman* v. *Warwick*, 108 Fed. 46, 48, with respect to a stamp tax on the qualifying bond required of a notary public, said that it was immaterial whether the notary's compensation came from the State or from private persons. In *Freedman* v. *Commissioner*, 92 F. (2d) 150 (C. C. A. 3d), pending on petition for writ of certiorari, No. 597, the court held that an employee of the State Department of Justice, whose salary was paid from the assets of liquidating banks, was immune from taxation. In *Hoskins* v. *Commissioner*, 84 F. (2d) 627 (C. C. A. 5th), the court held the compensation of one employed in a school cafeteria to be exempt, without considering that it was paid out of cafeteria receipts.

On the other hand, the Circuit Court of Appeals for the Second Circuit, in *McLoughlin* v. *Commissioner*, 89 F. (2d) 699, 701, pending in this Court, No. 287, held, with respect to the salary of counsel employed by the State and paid out of the assets of liquidating insurance companies, that "there can be no exemption from Federal taxation where, as

here, taxation would result in no burden upon the governmental power of the state." In *Helvering* v. *Curren,* 90 F. (2d) 621 (C. C. A. 2d), the court, while holding that the compensation of counsel to a county clerk was tax-exempt, said (p. 622):

> A tax does not as such impede state officials in the performance of their duties; it can scarcely be said to invade the state's sovereignty, save as it may require the official's salary to be correspondingly raised. Even that would seem to be generally an "indirect" result, for the rise need not inevitably follow; the incumbent might accept the cut rather than throw up his position. * * *

In *Miller* v. *McCaughn,* 27 F. (2d) 128 (C. C. A. 3d), the court held taxable the compensation of an auditor, appointed by the state court and paid by the surety companies who applied for bond-writing. It said (p. 128):

> The exemption of state employees from federal income tax rests on the ground that the agencies the state employs in government should not be burdened by federal taxes, which would lessen the state's power to employ, and compel it to pay more for the services of its employees. * * *

In *New York Trust Co.* v. *United States,* 63 C. Cls. 100, 102, certiorari denied, 274 U. S. 756, the court held the plaintiff's compensation, received for acting as executor, guardian, a comimttee, etc., in state courts, to be taxable, in part because "its compen-

sation was not paid by the State but indirectly by the private person or persons interested in the estate in each case." In *Saxe* v. *Anderson,* 19 F. Supp. 21, 26 (S. D., N. Y.), certiorari denied, No. 398, this Term, pending on appeal, Judge Knox held the compensation of a referee taxable; cases in other jurisdictions were put aside because the taxpayer before him derived his compensation from the private litigants. This factor was said to be "of importance and goes to the heart of the basis of the exemption, viz., the burden imposed upon the sovereign." In *Harman* v. *Helvering,* 90 F. (2d) 622 (C. C. A. 2d), pending on petition for writ of certiorari, No. 433, this Term, the court held taxable a court stenographer's fees from litigants. It based the decision on the conclusion that the services were not essentially governmental, but said (p. 623):

> it is tempting to say that, as the state's treasury is not concerned, the tax must necessarily be valid * * * no one has ever given any other rational reason for the whole doctrine.*

Finally, in *Commissioner* v. *Ogden,* 62 F. (2d) 334 (C. C. A. 1st), the court held a court auditor, whose compensation was paid by the county, to be tax-

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*The omitted portions of the quotation state (1) "the cases will scarcely bear out such a test," and (2) "we refused to base our decision on it in *McLoughlin* v. *Commissioner,* 89 F. (2d) 699." The first statement, we believe, is due to a failure to consider the distinction advanced below, pp. 31–32, and the second is plainly wrong.

exempt. It said (p. 335) that "non-statutory auditors, generally paid by the parties, stand upon a very different footing."

The Board of Tax Appeals has followed a vacillating course. In *Todd* v. *Commissioner*, 15 B. T. A. 962, and *Cahn* v. *Commissioner*, 13 B. T. A. 1362, it held trustees and executors appointed by state courts taxable on their compensation, which was paid out of private funds. But in *Cochrane* v. *Commissioner*, 26 B. T. A. 1167, and *Winne* v. *Commissioner*, 27 B. T. A. 369, it rejected the test of the source of the compensation and held the fees of masters in chancery to be exempt. Finally, it has held the source of the compensation to be a persuasive, even though not controlling, factor, and has held receivers appointed by state courts to be taxable. *Wright* v. *Commissioner*, 29 B. T. A. 1267; *Abbott* v. *Commissioner*, 30 B. T. A. 227; *Strickland* v. *Commissioner*, 32 B. T. A. 804.

The Bureau of Internal Revenue has not been consistent in its rulings.[10] Prior to 1934 the Commissioner of Internal Revenue held that the source of the taxpayer's compensation was immaterial.[11]

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[10] Since the rulings seek to interpret a constitutional rather than a statutory provision, those prior to 1934 did not gain an added force by virtue of Congressional reenactment. Compare *Helvering* v. *Powers*, 293 U. S. 214, 225.

[11] See O. D. 1053, 5 Cumulative Bulletin 106 (fees of deputy sheriffs); I. T. 1316, I-1 Cumulative Bulletin 105 (compensation of deputy bank examiners appointed by a state bank examiner and paid out of the assets of insolvent banks); I. T. 1652, II-1 Cumulative Bulletin 71 (compensa-

However, since that date, the Commissioner has consistently taken the position that the compensation as an officer or employee of a State or political subdivision is subject to the federal income tax if it is not paid out of public funds, since the imposition of the tax in such a case does not burden the State so as to constitute a substantial and direct interference with the exercise of a sovereign function.[12]

3. It seems quite plain to us that a tax on compensation paid out of private funds, *ex hypothesi*, cannot contain a threat of destruction of our dual system of government.

In *James* v. *Dravo Contracting Co., supra,* and the related cases, the Government argued that cost alone could not be the test of a forbidden interfer-

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tion of state employees paid in part out of Federal contributions to the state); I. T. 1693, II-1 Cumulative Bulletin 72 (fees of public administrators); I. T. 2030, III-1 Cumulative Bulletin 117 (fees of public administrator in Montana); I. T. 2214, IV-2 Cumulative Bulletin 46 (compensation of receiver of insolvent Kansas bank); G. C. M. 60, V-1 Cumulative Bulletin 45 (compensation of secretary of Kansas State Fair Board paid largely from fair earnings); G. C. M. 11625, XII-1 Cumulative Bulletin 69 (fees of special masters in chancery in Illinois); I. T. 2710, XII-2 Cumulative Bulletin 79 (employees of state banking department paid out of insolvent bank assets); I. T. 2677, XII-1 Cumulative Bulletin 141 (compensation of teacher paid out of federal grants).

[12] See G. C. M. 13488, XIII-2 Cumulative Bulletin 156 (bank liquidator); I. T. 2859, XIV-1 Cumulative Bulletin 101 (state Emergency Relief Administrator); G. C. M. 14116, XIV-1 Cumulative Bulletin 102 (public administrator); G. C. M. 14957, XIV-2 Cumulative Bulletin 130 (notary public).

ence with the dual system of government—the cost must be imposed specially on those who dealt with the other sovereign, i. e., a discriminatory tax, or it must be regulatory or prohibitory in effect, before the private person could find shelter behind the cloak of sovereign immunity. But even in the case where the tax on an individual is such that it is held to be a threat to our dual system of government, it is to be noted that it possesses this potential danger only because it will be reflected in the sovereign's treasury. A tax on one who is not the sovereign cannot possibly affect that government unless in some manner the amounts paid by the sovereign will be increased because of the tax. Thus, while no tax on an individual should be considered to contain a threat to the dual system of government merely because it results in an added cost to the sovereign,[13] a tax on an individual cannot even be considered as a possible threat to that dual system unless it does result in added costs to the sovereign. The tax which is imposed on an individual, and is in no manner passed on to the sovereign, is one which is wholly irrelevant to the sovereign. Such, we submit, is the case here.

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[13] We believe the discussion of the constitutional doctrine of inter-governmental tax immunity is clarified if the two senses of the term "burden" be distinguished. It may on the one hand mean an added *cost* to the sovereign. This does not necessarily mean that the tax is unconstitutional. See, e. g., *Trinityfarm Co.* v. *Grosjean*, 291 U. S. 466; *Liggett & Myers Co.* v. *United States*, 299 U. S. 383. The

There is nothing inherently unconstitutional in taxing one who is employed by or who deals with the sovereign. The government official must pay property, inheritance and excise taxes to the other sovereign; his income other than the salary paid by the government is taxable. The only conceivable basis, it seems to us, for exempting his government-paid salary is because a tax so measured might be thought to be an interference with our dual system because it would result in the necessity that a higher salary be paid out of the public treasury.

In this case, even if it be assumed that a net income tax will so discourage the respondent that he will refuse to perform his services without higher pay, the resulting increase in compensation cannot affect the State. The additional compensation will come from the assets and income of the insolvent banks. This may have some tendency to reduce the recovery by creditors and stockholders, just as the taxation of the president of a solvent state bank may have the same effect. But it obviously cannot result in an added charge against the State treasury.

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term "burden" may on the other hand mean an *interference* with the sovereign such as to threaten our dual system of government. A tax with such consequences is invalid. It is, therefore, a serious logical fallacy to reason that an added cost is a "burden," that a "burden" is unconstitutional, and that a tax which results in an added cost is therefore unconstitutional.

The epochal dictum of Chief Justice Marshall, that the power to tax is the power to destroy (*McCulloch* v. *Maryland,* 4 Wheat. 316, 427) was considered by him to be an inexorable constitutional principle because questions of degree were "so unfit for the judicial department" (p. 430). This Court has long since rejected both the premise and the conclusion of this bold syllogism.[14] But even if this great dictum be given its full force, its application leads inevitably to the conclusion that the power to tax the respondent contains the possibility of destruction, not for the State of Florida, but only for the assets of the insolvent bank. And, so far as we know, none has ever suggested any reason why insolvent banks, as opposed to those which are solvent, are essential to the independence of the State from the central government.

It will be noted that our present argument does not go to the point of urging the validity of a tax on all government employees for whose compensation the state is reimbursed by private persons. To illustrate, the clerk of a court or a sheriff may be authorized to collect fees and fines, and may be allowed to retain a certain amount or percentage. We do not believe we should be justified in urging, if these officials collected the money in exercise of

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[14] See, in the body of constitutional doctrine relating to intergovernmental tax immunity, *Plummer* v. *Coler*, 178 U. S. 115; *Greiner* v. *Lewellyn*, 258 U. S. 384; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523; *Willcuts* v. *Bunn*, 282 U. S. 216; *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279, 282.

an essential governmental function, that they were paid out of private funds. The state requires the fees and fines in order to swell its revenues and the officials are paid in return for performing an essential governmental function. They are not, as in the present case, paid out of private funds in which the State has no interest. The clerk's fees are government revenues; the assets of an insolvent bank are not.

In summary, our two main propositions seem almost indisputably clear: The reason a government officer or employee is tax exempt on his salary, but in no other respect, must be because it is feared that a tax so measured would impose additional costs on the public treasury, in a manner such as to threaten our dual system of government. If the salary or compensation is in fact paid out of private funds, there cannot possibly be a danger to the public treasury or to the sovereign.

4. This Court has often pointed out that the doctrine of tax exemption must be limited to the necessity of the principle upon which it is founded. "Springing from that necessity it does not extend beyond it". *Board of Trustees* v. *United States*, 289 U. S. 48, 59. Accordingly, if the taxpayer cannot affirmatively show that his subjection to taxation threatens to disrupt our dual system of government, he will not be granted immunity. *Helvering* v. *Powers*, 293 U. S. 214, 224–225; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523; *Indian Ter-*

ritory Oil Co. v. *Board,* 288 U. S. 325, 328; *Willcuts* v. *Bunn,* 282 U. S. 216, 225; *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 391; *National Bank* v. *Commonwealth,* 9 Wall. 353, 362.

Correlatively, this Court has been aware of the imperative importance that there be no attrition of the sources of tax revenues. In *Willcuts* v. *Bunn,* 282 U. S. 216, 225, the Court declared:

> The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government.

See also *Helvering* v. *Powers,* 293 U. S. 214, 225; *United States* v. *California,* 297 U. S. 175, 184–185; *Susquehanna Co.* v. *State Tax Commission (No. 1),* 283 U. S. 291, 294. This factor becomes of increasing significance as the scope and variety of governmental functions expand. It is unnecessary to cite statistics to demonstrate the dependence of the federal government, and of many state governments, upon the revenues obtained from the income tax upon individuals. These revenues are

seriously impaired by *Collector* v. *Day, supra,* and the cases which have followed it. To push the doctrine of employee immunity into new fields, and to grant the largesse of tax exemption even to those who are not paid out of public funds, would have the most alarming consequences. The taxation of such individuals would not contain even a remote or conjectural effect on state operations—indeed, such taxation seems to us demonstrably and inescapably to be wholly irrelevant to the finances of the State. On the other hand, to exempt from taxation this new and very large category[15] of

[15] It is impossible to estimate the number of persons who would gain an exemption from federal taxation if it were held that their employment or designation by State officials resulted in an immunity whether or not they were paid from state funds. The taxpayers who have sought rulings from the Bureau of Internal Revenue (in addition to the published rulings cited in footnote 4, *supra*) since 1934 are illustrative; masters in chancery (G. C. M. 16242); unemployment compensation commission (G. C. M. 18152); teachers in federal land grant colleges (G. C. M. 14622); state board of health, paid with federal funds (G. C. M. 18089); coaches of athletic teams paid with admission receipts (G. C. M. 16169); costs collected by justices of the peace (G. C. M. 15949); members of National Guard paid by the United States (G. C. M. 13188).

In the field of insolvent banks alone, it is to be noted that 47 of the 48 States expressly provide that the expenses and compensation of the liquidator shall be paid out of the assets of the insolvent bank. (The state statutes are listed in Appendix B, *infra*, p. 55. Only Maine has no express provision.)

individuals would have a certain and a serious impact upon government revenues. We respectfully submit that the Constitution cannot require that the federal and state governments be crippled in their search for revenues when the only compensatory gain would be a wholly capricious exemption of individual taxpayers, paid out of private funds, and differing from their fellow business men who are taxed only in that, under a somewhat different form of state supervision, they conduct the business of an insolvent instead of a solvent institution.

III

THE RESPONDENT WAS NOT AN OFFICER OR EMPLOYEE OF THE STATE BUT WAS AN INDEPENDENT CONTRACTOR

Apart from the fact that respondent's compensation came from private rather than State funds, and whether or not the liquidation of banks is an essential governmental function, he cannot claim exemption from taxation because he is not an officer or employee of the State.

It is thoroughly settled that compensation paid by the State, even for services in connection with an essential governmental function, is not immune from federal taxation if the relationship of the taxpayer be that of an independent contractor, rather than that of an officer or employee. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; *Lucas* v. *Reed*,

281 U. S. 699; *Lucas* v. *Howard,* 280 U. S. 526; *General Construction Co.* v. *Fisher,* 295 U. S. 715. The only question, then, is one of the factual circumstances of this case. We submit that they require the conclusion that respondent was not an officer or employee of the State.

1. It is unnecessary to elaborate the argument that respondent was not an officer of the State of Florida. His duties were restricted to liquidating the specific banks and trust companies for which he was appointed. He received no commission from the Governor and took no oath of office. The Florida statutes require that each officer receive a commission from the Governor and take an oath of office; neglect or refusal so to qualify results in the office being vacant. Comp. Gen. Laws of Florida, Secs. 460, 461; *Advisory Opinion to the Governor,* 14 Fla. 277; *Advisory Opinion to the Governor,* 65 Fla. 434. The Board found that respondent was not an officer (R. 52) and the majority of the court below, while declaring the respondent to be "a public official and an instrumentality," recognized that he was "not a public officer in the full sense" (R. 64).

2. The more difficult question is whether respondent is an employee or an independent contractor. To a large extent this turns on the particular circumstances of the case. The findings of the Board of Tax Appeals as to the evidentiary

facts are conclusive.[16] To the extent that the ultimate conclusion of the Board is based on these evidentiary facts it cannot be reviewed. *Helvering* v. *Rankin*, 295 U. S. 123, 131; *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37. The decision of the Board (R. 52), that the tax was imposed on "one who is neither an officer nor an employee of the government and whose only relation to it is that of contract" may in part be based upon factual evidence, such, for example, as the extent of the control exercised over respondent by the Comptroller. Accordingly, the judgment of the court below must be reversed unless this Court should hold as a matter of law (cf. *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, 491; *Bogardus* v. *Commissioner*, No. 15, this Term) that *no* factual circumstances could serve to alter a conclusion that respondent was an employee of the State. We submit that this is not the case and that, on the contrary, respondent was plainly not an employee of the State.

The court below held that respondent was "not a public officer in the full sense" (R. 64). It did not hold that respondent was an employee of the

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[16] Respondent assigned error neither to the admission or rejection of evidence nor to the findings of the Board. Accordingly, this record contains no statement of the evidence before the Board (R. 58). See *Helvering* v. *Ward*, 79 F. (2d) 381 (C. C. A. 8th); *Winnett* v. *Helvering*, 68 F. (2d) 614 (C. C. A. 9th); *Commissioner* v. *Proctor Shop*, 82 F. (2d) 792 (C. C. A. 9th); *Cass* v. *Helvering*, 83 F. (2d) 841 (C. C. A. 8th).

State. This would seem to compel the conclusion that respondent was, as the Board held, an independent contractor. Instead, the court created a new and amorphous category, "a public official and an instrumentality appointed by the State," and assigned the privilege of tax exemption to persons who fell within it. This, we submit, was patent error.

The Florida statutes seem persuasive that the liquidator is not an employee of the Comptroller but is, rather, a contractor who after his appointment has substantially the status which the bank, whose affairs he is to conduct, had prior to its insolvency. The same act which provided for the appointment of a liquidator provides in Section 14, amending Section 4159 of the Revised General Statutes (*infra,* p. 47):

> That the Comptroller in the supervision of banks and trust companies, shall have power to employ a bank report analyst and not more than twelve discreet and competent persons to examine into the affairs of every bank, banker, banking company or trust company, doing business in the State, *and liquidators thereof,* except National Banks, and the persons so employed shall have power to make a thorough examination into all the affairs of each and every such bank, banker, banking firm, banking company or trust company *and liquidating agencies,* at any time; and in doing so shall have access to all the books, papers, records, securities and assets of all kinds, and shall be author-

> ized to examine any of the officers, directors, agents or employees, of such bank, banker, banking firm, banking company, trust company *or liquidators thereof,* under oath, and such examiners shall make a full and detailed report to the Comptroller of the conditions of each bank, banking company, trust company *or liquidating agency* thereof so examined. Provided, that no person connected with the banking business, either as an officer, director, agent or employee shall be so employed. [Italics added.]

It is too plain for argument that this statute authorizes the employment of examiners to supervise banks *and their liquidators.*[17] Thus, the Florida

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[17] The Supreme Court of Florida in *Ex parte Amos*, 100 Fla. 687, on habeas corpus released the Comptroller who had been taken into custody because of malfeasance. The original affidavit alleged that the Comptroller willfully employed officers, etc., of the Bank of Bay Biscayne "in connection with the examination of the Bank." The State court held the affidavit consistent with the inference that the Comptroller had merely employed assistants to administer the affairs of the bank after it had ceased to do business. By obvious inadvertence (due to repeating only the first clause of Section 14, which has ambiguous punctuation), the court said (p. 690): "The affidavit does not allege that the petitioner employed persons connected with the banking business as a bank report analyst or as bank examiners *or liquidators.*" (Italics added.) The inference of the italicised words is (1) plainly not necessary to the decision of the case, (2) patently inadvertent, and not that "considered dictum" (*Hawks* v. *Hamill*, 288 U. S. 52, 59) which federal courts will ordinarily follow, and (3) has not been adopted by the State officials, as shown by the record in this case.

statutes treat liquidators as having the status of active banks, even to the point of subjecting them to the same examination by the Comptroller's employees. This is wholly inconsistent with any view that the liquidator himself is an "employee" of the Comptroller.

The other circumstances of this case offer cogent support to this conclusion. The respondent was not hired by the month or year, or for an indefinite period of time. He was appointed, just as would be any contractor, to do a particular job. When he undertook to liquidate other institutions he received a new appointment for each one (R. 50; R. 19–20, 31–32, 33–34, 43–44). Were he an employee, one would suppose that the Comptroller would merely direct him to liquidate the other institutions as well. Instead, the procedure applicable to a contractor who assumes additional contracts was followed.

Similarly, respondent was paid by the job, instead of by the month or year as would be the case with an employee. His compensation was $8,555.61 in 1931, and $39,448.07 in 1932. A 460 per cent increase in compensation over the previous year is assuredly more typical of the contractor than the employee of the State. Especially is this the case when it is noted that even in 1931 his compensation was considerably in excess of that of the Comptroller, his supposed superior, who in 1931 received only $6,000 (Laws of 1931, ch. 15720, sec. 1).

There is nothing in the appointments or the statutes which forbids a liquidator from carrying on a private business at the same time. An employee, as opposed to a contractor, is ordinarily not allowed to carry on a private business. In this connection, it is the power to engage in other activities, not the actual extent to which it is done, which is important; an independent contractor may well devote full time to the job. While respondent's other activities were not very extensive, they seem clearly to negative the status of an employee. He continued in his capacity as inactive president of the bank at Ocala, and continued to attend directors' meetings (R. 50). This would, even apart from statutory provision, be a matter of very doubtful propriety were respondent in fact an employee of the State department which supervised banks. But when the Florida statutes are considered, it seems fairly clear that respondent could not have continued as director and inactive president of the Ocala bank and at the same time have been an employee of the Comptroller. The Comptroller's banking supervision is accomplished through assistants, of whom only the bank report analyst and the bank examiners are provided for by statute. None of these can be appointed if he has connections with a bank (Rev. Gen. Stats., Sec. 4159, as amended, *infra*). If respondent were in fact an employee of the Comptroller, it is unlikely that he should be allowed to maintain his banking

connections, much less that he should be subject to the same examination by bank examiners as are active institutions.

Finally, there is the question of the extent of the control which the Comptroller exercised over respondent. An absence of control by the State officials was given decisive weight in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 520–521:

> Nor do the facts stated in the bill of exceptions establish that the plaintiffs were "employees" within the meaning of the statute. So far as appears, they were in the position of independent contractors. The record does not reveal to what extent, if at all, their services were subject to the direction or control of the public boards or officers engaging them. In each instance the performance of their contract involved the use of judgment and discretion on their part and they were required to use their best professional skill to bring about the desired result. This permitted to them liberty of action which excludes the idea of that control or right of control by the employer which characterizes the relation of employer and employee and differentiates the employee or servant from the independent contractor. * * *

The petition alleged that respondent "was continuously under the direction and control of the Comptroller" (R. 7). The answer denied this (R. 48). The Board, after hearing the evidence

(R. 1), found that, while respondent was "under the direct supervision of the Comptroller", his only relation to the State was "that of contract, under which there is an obligation to furnish service, for practical purposes not unlike a contract to sell and deliver a commodity" (R. 50, 52). It must therefore be taken as conclusive (see *supra*, p. 37) that the control which the Comptroller in fact exercised over respondent was of a character such that the relationship was one of contract rather than of employment.

Such facts as the record discloses tend to indicate that this was the case. The respondent supervised a number of persons employed in various capacities in liquidating the insolvent institutions the affairs of which he was conducting (R. 50). Respondent had been the president of a bank and was inactive president of the Ocala bank during the years in question (R. 50). His qualifications show him to be a man of judgment, discretion and professional skill. It is most unlikely that the Comptroller's supervision (Section 4162, Rev. Gen. Stats., *infra*) extended beyond directing respondent *what* to do—i. e., liquidate the institutions—or that the Comptroller directed respondent *how* to do this. In any event, the record does not show to what extent, if any, the respondent's services were in fact subject to the direction and control of the Comptroller, nor does it show that the performance of his duties as liquidator did not involve the use

of his judgment and discretion, requiring the respondent's best professional skill and a full liberty of action. In view of the findings of the Board, it must be taken that the evidence showed the exercise of the independent judgment and liberty of action which distinguishes the contractor from the employee.

To render one an employee, the right of control must be complete and extend to the details of the work. *Childers* v. *Commissioner,* 80 F. (2d) 27 (C. C. A. 9th); *Commissioner* v. *Modjeski,* 75 F. (2d) 468, 471 (C. C. A. 2d), certiorari denied, 295 U. S. 764. The test for determining whether one is an employee or an independent contractor was well formulated in *Haight* v. *Commissioner,* 52 F. (2d) 779, certiorari denied, *sub nom. Adcock* v. *Commissioner,* 285 U. S. 537, where the Circuit Court of Appeals for the Seventh Circuit said (p. 781):

> The record in this case shows that Adcock, in rendering his services to the sanitary district, was under the general direction and supervision of its general attorney. This was required by the rules and regulations of the board of trustees. All this amounts to is that Adcock would report to the general attorney from time to time as to what had been done, and consulted with him. It does not show that the general attorney exercised any detailed control as to what should be done, and how it should be done, which is essential to the relationship of employer and employee.

We submit that the same considerations which have required the conclusion that a lawyer, carrying on his general practice, who is engaged by a state and its political subdivisions and public agencies is not an officer or employee of the state or subdivision or agency (*Lucas* v. *Reed,* 281 U. S. 699; *Lucas* v. *Howard,* 280 U. S. 526; *Buckner* v. *Commissioner,* 77 F. (2d) 297 (C. C. A. 2d) apply with equal force to a bank president who is engaged to render the equivalent of professional services as a liquidator of banking institutions.

In result, the statutes of Florida, the method of appointment and compensation, the continued service as inactive president and director of a bank, and the freedom from control by the Comptroller, all indicate that respondent was not an employee but in substance an independent contractor undertaking to liquidate specified insolvent banks and trust companies. He is, therefore, subject to federal taxation upon the net income realized in this activity.

CONCLUSION

The tax in question is not forbidden by the implications of the Constitution, in that it is imposed (1) with respect to an activity which is not an essential governmental function, (2) on compensation derived from private rather than State funds, and (3) on the compensation of one who is neither an officer nor an employee of the State.

Any one of these propositions is sufficient to support the determination of the Commissioner and the decision of the Board of Tax Appeals. The judgment of the court below should, therefore, be reversed.

Respectfully submitted.

STANLEY REED,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
BERRYMAN GREEN,
Special Assistants to the Attorney General.
WARNER W. GARDNER,
Special Attorney.

NOVEMBER 1937.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever.
>
> * * * * * *

Revenue Act of 1932, c. 209, 47 Stat. 169:

Section 22 (a), in so far as here pertinent is substantially the same as Section 22 (a) above quoted.

Florida Laws of 1929, vol. 1, c. 13576:

> SECTION 14. That Section 4159 of the Revised General Statutes be amended so as to read as follows:
>
> "SECTION 4159. That the Comptroller in the supervision of banks and trust companies, shall have power to employ a bank report analyst and not more than twelve discreet and competent persons to examine into the affairs of every bank, banker, banking company or trust company doing business in the State, and liquidators thereof, except National Banks, and the persons so em-

ployed shall have power to make a thorough examination into all the affairs of each and every such bank, banker, banking firm, banking company or trust company and liquidating agencies, at any time; and in doing so shall have access to all the books, papers, records, securities and assets of all kinds, and shall be authorized to examine any of the officers, directors, agents or employees, of such bank, banker, banking firm, banking company, trust company or liquidators thereof, under oath, and such examiners shall make a full and detailed report to the Comptroller of the conditions of each bank, banking company, trust company or liquidating agency thereof so examined. Provided, that no person connected with the banking business, either as an officer, director, agent or employee shall be so employed."

SECTION 16. That Section 4161 of the Revised General Statutes of the State of Florida be amended so as to read as follows:

"SECTION 4161. EXAMINATION OF BANKS AND TRUST COMPANIES, EXAMINATION FEES. That each bank, banking firm, banking company, trust company and liquidating agency, doing business in the State of Florida, except National Banks, shall be examined at least twice in each year, and oftener if deemed necessary; and for each examination so made each bank, banker, banking firm, banking company, or trust company shall pay into the State Treasury an examination fee based upon the resources of each bank or trust company as follows: * * *"

SECTION 19. That Section 4162 of the Revised General Statutes of the State of Florida be amended so as to read as follows:

"SECTION 4162. COMPTROLLER MAY APPOINT LIQUIDATOR; DUTIES OF LIQUIDATOR; NOTICE TO BANK OFFICERS; CONFIRMING APPOINTMENT. On becoming satisfied, from the reports furnished to him by a State Bank Examiner, or upon other satisfactory evidence thereof, that any bank, banking firm, banker, banking or trust company, or corporation doing business in this State under the State laws, has become insolvent and is in default, or that the affairs of any bank, banker, banking firm or trust company or corporation doing business in this State, under such State laws, is in an unsound condition, or threatened with insolvency because of illegal or unsafe investments, or that its liabilities exceed its assets, or that it is transacting business without authority of law or in violation of law, or if the directors of any bank, banking or trust company, or corporation, or any banker or the management of any banking firm doing business in this State under the State laws, shall knowingly violate, or knowingly permit any of its officers, agents or servants to violate any of the provisions of law relative to such bank, bankers, banking firms, banking or trust companies, or corporations doing business in this State, the rights, privileges and franchises shall be subject to be forfeited, and the State Comptroller may in his discretion forthwith designate and appoint a liquidator to take charge of the assets and affairs of such bank, and require of him such bond and security as the Comptroller deems proper, not exceeding double the amount that may come into his hands, and such liquidator shall be subject to dismissal by the Comptroller, whenever in his judgment such dismissal is deemed neces-

sary or advisable; when one liquidator is dismissed, another may be duly designated and appointed. Such liquidator under the direction and supervision of the Comptroller, shall take possession of the books, records and assets of every description of such bank, banker, banking firm, banking and trust company, or corporation, and in his name shall sue for and collect all debts, dues and claims belonging to it, and upon the order of a court of competent jurisdiction may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such bank, banker, banking firm, banking and trust company, or corporation, on such terms as the court shall direct; and may, if necessary, to pay the debts of such bank, banker, banking firm, banking and trust company, or corporation, sue for and enforce the individual liability of the stockholders. Such liquidator shall pay all money received by him to the State Treasurer to be held as a special deposit for the use and benefit of the creditors, subject to the order of the Comptroller, and shall also make quarterly reports to or when called upon, to the Comptroller of all of his acts and proceedings. The Comptroller, immediately upon appointing such liquidator, shall serve notice upon the president, or upon any vice-president or cashier, or upon any director or other person having the charge or management of any such bank, banker, banking firm, banking or trust company, or corporation, informing him or them in such notice of his action in appointing such liquidator, and notifying him or them or it that he would apply on a date therein named, not to exceed ten days from the date of service of such notice, to some circuit judge

having jurisdiction over the same, for an order confirming his action and the appointment of a liquidator for such banking institution and such bank, banking firm, or banking or trust company, or corporation may, at such hearing contest before such circuit judge the rightfulness and legality of such action of the Comptroller in appointing such liquidator."

SECTION 20. The Comptroller may provide for the administration of the affairs of institutions under the above section by one general liquidator who shall be designated by the Comptroller as a General Liquidator for the administration of the affairs of several or all of the instructions in liquidation, whose compensation shall be paid by the Comptroller, to be paid in such proportions out of the assets of the institution whose affairs are being administered as the Comptroller may determine, not exceeding in the aggregate Six Thousand ($6,000.00) Dollars per annum. The Comptroller may provide for the transfer at any time to the general liquidator of the affairs of any institution for which a particular liquidator or receiver has been heretofore or shall hereafter be designated and the general liquidator shall be thereupon vested with all the rights conferred by law on such general liquidator as if he had been designated in the first instant to act as such.

SECTION 21. That Section 4164 of the Revised General Statutes of the State of Florida be amended so as to read as follows:

"SECTION 4164. EXPENSES OF LIQUIDATING AGENT OR AGENTS; COMPENSATION OF LIQUIDATORS; DEPOSITION OF BANK'S FUNDS.—All expenses of any liquidator shall be paid out of the assets of such bank, banker, banking firm, banking or trust company, or corpora-

tion before distribution of the proceeds thereof. The compensation of the liquidator shall be fixed by the Comptroller, and shall be based upon the amount of work actually necessary and performed, and shall in no case exceed five per cent of the cash collections. From time to time, after full provisions having first been made for the expenses of the liquidating agency, and the payment of liens for taxes and preferred claims, the Comptroller shall make ratable dividend of the money in the hands of the State Treasurer on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and as the proceeds of the assets of such bank, banker, banking firm, banking or trust company, or corporation, are paid over to the liquidator, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, after all claims have been paid, shall be paid over to the shareholders, of such bank, banker, banking firm, banking or trust company, or corporation, or their legal representatives in proportion to the stock by them respectively held, or their interest therein as appearing."

SECTION 22. That Section 4165 of the Revised General Statutes of the State of Florida be amended so as to read as follows:

"SECTION 4165. COMPTROLLER MAY PURCHASE PROPERTY TO PROTECT LIQUIDATOR'S TRUST.—Whenever any liquidator, duly appointed by the Comptroller, and who shall have qualified and entered upon the discharge of his trust, shall find it in his opinion necessary to fully protect and benefit his said trust, to the extent that said trust may have in any property, real or personal, by reason of any bond, mortgage, lien, assign-

ment, equity or other proper legal claim attaching thereto, and which said property is to be sold under execution, decree or foreclosure, or any proper order of any court of competent jurisdiction, or reclaimed or repossessed by any person having title opposed to such equity of his trust, he may certify the facts in the case, together with his opinion as to the value of the property, and the value of the equity his trust may have in same, and the amount that may be necessary to purchase such property, to the Comptroller, and if the Comptroller shall in his judgment deem it to the best interest of the said trust, he shall be and is empowered to draw upon the funds to the credit of said trust in the hands of the State Treasurer to the amount necessary for the purchase of said property for the said trust."

Treasury Regulations 74:

ART. 56. STATE CONTRACTS.—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. * * *.

ART. 643. COMPENSATION OF STATE OFFICERS AND EMPLOYEES.—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State

courts are subject to tax for 1928 and subsequent taxable years.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary. * * *

Treasury Regulations 77:

Article 56 and Article 643 are identical with the corresponding articles of Treasury Regulations 74, quoted above.

APPENDIX B

There follows a very rough classification of the procedures adopted by the several States for the liquidation of insolvent banking institutions:

1. Administrative determination of insolvency, followed by judicial confirmation and appointment of receiver subject to full judicial supervision: South Carolina, Code of 1932, Sections 7852–7855; Virginia, Code of 1936, sec. 4149 (52).

2. Administrative determination of insolvency, followed by mandatory appointment of state banking official as receiver, subject to full judicial supervision: Connecticut, General Statutes (1935 Supp.), Secs. 1437c; Delaware, Revised Code, 1935, Secs. 2294–2297; Iowa, Code of 1935, Secs. 9239–9243; Maine, Revised Statutes, 1930, ch. 57, Sec. 52; Michigan, Annotated Statutes, 1937, Sec. 2364 (as amended by Financial Institutions Act, 1937); Minnesota, Statutes, 1927, sec. 7682, and Laws of 1933, ch. 232; New Hampshire, Public Laws, 1926, ch. 268; New Mexico, Laws of 1933, ch. 32; North Dakota, Laws of 1931, ch. 96, Secs. 50–51; Rhode Island, General Laws, 1923, ch. 274, Sec. 7; South Dakota, Compiled Laws, 1929, Secs. 8924–8937; Tennessee, Code of 1932, Secs. 5964–6000; Texas, Vernon's Statutes, Banks, Articles 368–371, 451–474; Vermont, Public Laws of 1933, Secs. 6749–6760.

3. Administrative determination of insolvency, followed by administrative liquidation or administrative appointment of receiver; subject to limited judicial supervision: Arizona, Revised Code (1928 and 1936 Supp.), Secs. 245–249; Arkansas,

Pope's Digest, Secs. 738–739, 767–770; California, General Laws, Act No. 652; Colorado, Compiled Laws, 1921, Secs. 2725–2750; Florida, Revised General Statutes 4162–4167; Illinois, Jones' Statutes, Sec. 10.11; Kansas, General Statutes, Sec. 9–130; Kentucky, Carroll's Statutes, 1936, Secs. 165a–16, 165a–17; Louisiana, General Statutes, 1932, Secs. 697–715; Maryland, Annotated Code (1924 and 1935 Supp.), Art. 11, Secs. 8–9D; Massachusetts, General Laws, 1932, ch. 167, Secs. 22–36; Mississippi, Code of 1930, Secs. 3816–3817; Missouri, Revised Statutes, 1929, Secs. 5316–5323; Montana, Revised Code, 1935, Secs. 6014.131–6014.150; Nebraska, Compiled Statutes, 1929, Secs. 8–184, 8–194; New Jersey, Compiled Statutes, pp. 173–178, Cumulative Supplement 1911–1924, Secs. 17–24; New York, Banking Law, Secs. 57–81; North Carolina, Code of 1935, ch. 5, Sec. 218; Oregon, Code, Secs. 22–1901 to 22–2019; Pennsylvania, Purdon's Statutes, Title 7, Secs. 21–50; Utah, Revised Statutes, 1933, ch. 7–2; West Virginia, Code of 1931 (as amended in 1937), ch. 31, Sec. 32; Wisconsin, Statutes, 1935, Sec. 220.08; Wyoming, Revised Statutes, 1931, Secs. 10–501 to 10–528.

4. Administrative determination of insolvency, followed by administrative liquidation or receivership, subject to judicial review only on objection of claimants, etc.: Alabama, Civil Code of 1923, Secs. 6299–6324; Georgia, Code of 1937, Secs. 13–801, *et seq.;* Idaho, Code of 1932, Secs. 25–901, *et seq.;* Nevada, Compiled Laws, 1929, Secs. 702–711; Ohio, General Code, 1936, Secs. 710–88a to 710–106; Oklahoma, Laws of 1937, ch. 40, Secs. 72–87; Washington, Remington's Revised Statutes, Secs. 3266–3280.

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Supreme Court of the United States

OCTOBER TERM, 1937.

No. 128.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL, RESPONDENT.

RESPONDENT'S BRIEF.

HARRY M. VOORHIS,
Attorney for Respondent.

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 128.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL, RESPONDENT.

RESPONDENT'S BRIEF.

The petition for certiorari apparently concedes that the respondent was an officer or employee of the state, engaged in an essential governmental function. This being true, the only point relied upon by the petitioner as a predicate for the writ sought is *the source of compensation paid respondent,* and this point, we submit, was removed from the realm of any serious controversy by this court in the case of *Brush* v. *Commissioner of Internal Revenue,* decided May 15th, 1937, and reported in 300 U. S. 352, wherein the salary of the petitioner received from the Bureau of Water Supply of the City of New York, a municipally owned and operated water plant, was held immune.

Respectfully submitted,

HARRY M. VOORHIS,
Attorney for Respondent.

July 12th, 1937.

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Supreme Court of the United States

OCTOBER TERM, 1937.

No. 128.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

JOHN H. THERRELL, ALSO KNOWN AS J. H. THERRELL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF OF RESPONDENT.

✓H. M. VOORHIS,
Orlando, Florida,
Attorney for Respondent.

H. M. HAMPTON,
Ocala, Florida,
Of Counsel for Respondent.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF OF RESPONDENT.

QUESTION PRESENTED.

Is the Compensation Received by the Respondent As Liquidator of Certain Florida State Banks, and Paid from Funds in the State Treasury Realized from Liquidating the Assets of Said Banks, Subject to Federal Taxation?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are set forth in the appendix, *infra*, pages 25-33.

STATEMENT OF THE CASE.

We believe that the statement as set forth in the brief of the petitioner is substantially correct.

SUMMARY OF ARGUMENT.

The argument will be divided into four subheadings, namely:

I. Respondent was an officer or employee of the State of Florida;

II. The respondent was engaged in an essential governmental function;

III. The source of the compensation of respondent is immaterial;

IV. Article 643 of Treasury Regulations 74 and Article 643 of Treasury Regulations 77 show administrative recognition of the respondent's contention.

ARGUMENT.

I.

Respondent Was an Officer or Employee of the State of Florida.

Section 19 of Chapter 13576 of the General Laws of Florida (1929) provides, among other things:

> "On becoming satisfied, from the reports furnished to him by a State Bank Examiner, or upon other satisfactory evidence thereof, that any bank * * *, doing business in this State under the State laws, has become insolvent and is in default * * *, the State Comptroller may in his discretion forthwith designate and appoint a liquidator to take charge of the assets and affairs of such bank, and require of him such bond and security as the Comptroller deems proper * * *, and such liquidator shall be subject to dismissal by the Comptroller, whenever in his judgment such dismissal is deemed necessary or advisable; when one liquidator is dismissed, another may be duly designated and appointed. Such liquidator, under the direction and supervision of the Comptroller, shall take possession of the books, [illegible]s and assets of every description of such bank * * *, and in his name shall sue for and collect all debts, dues and claims belonging to it, and upon the order of a court of competent jurisdiction may sell or compound all bad or doubtful debts, and on a like order, may sell all the real and personal property of such bank, * * * on such terms as the court shall direct; * * *. Such liquidator shall pay all money received by him to the State Treasurer to be held as a special deposit for the use and benefit of the creditors, subject to the order of the Comptroller, and shall also make quar-

terly reports to or when called upon, to the Comptroller of all his acts and proceedings."

Section 21 of Chapter 13576, General Laws of Florida (1929), provides, among other things:

> "All expenses of any liquidator shall be paid out of the assets of such bank, banker, banking firm, banking or trust company, or corporation before distribution of the proceeds thereof. The compensation of the liquidator shall be fixed by the Comptroller, and shall be based upon the amount of work actually done and performed, and shall in no case exceed five per cent of the cash collections."

Section 23 of Chapter 13576, General Laws of Florida (1929), provides:

> "The provisions of this Act shall apply to all receivers of any bank, banking firm, or banking or trust company, heretofore appointed by the order of any circuit court, and all such receivers, both these hereunder and those heretofore appointed by the circuit court, shall at all times be under the supervision and control of the Comptroller, and subject at all times to summary discharge and dismissal by him, and any vacancy in such receivership may be filled by the Comptroller at any time."

This court will note that the duties of a liquidator of a Florida state bank are almost identical with the duties of a receiver of a national bank; the wording of the Florida statute, Section 19, Chapter 12576, (*supra*) is practically identical with the wording of the National Bank Act, Section 192, U. S. C. A., Title 12, insofar as the duties of a Florida bank liquidator and a receiver of a national bank, respectively, are set forth.

The Supreme Court of the State of Florida has termed the liquidator an executive official or functionary of the state. In the case of *Therrell* v. *Rinaman*, 107 Fla. 110, 144 So. 327 (see page 329 of the Opinion), the Florida Supreme Court says:

> "The liquidator, whom the comptroller is authorized by the statute to appoint, is an executive creature of the legislative enactment, and can exercise only such powers as those with which, by force of the statute, he is expressly or impliedly vested. To put it another way, the comptroller and his statutory liquidators are executive officials or functionaries of the state, and neither is an officer of the court, which latter is required to adjudicate the fact of the bank's insolvency by confirming the comptroller's initial act of taking possession and control."

Again in the case of *Florida Bank & Trust Company* v. *Yaffey*, 101 Fla. 653, 136 So. 399, the Florida Supreme Court holds:

> "A bank liquidator of this state, under the statute provided for his appointment and controlling his duties, is a representative and agent of the comptroller and is not an officer of the court."

The Fifth Circuit Court of Appeals, in *Amos* v. *Trust Company of Florida*, 54 F. (2d) 123, comments upon the similarity of a Florida bank liquidator and the receiver of a national bank:

> "Like the receiver of a national bank, the liquidator, though confirmed by a court, is not an officer of the court but the representative of the comptroller."

This Honorable Court has held the receiver of a national bank to be an officer of the United States. We quote from a portion of the decision in the case of *Auten* v. *United States National Bank of New York*, 174 U. S. 125:

> "To sustain the motion to dismiss, it is contended that the jurisdiction of the case depends on diversity of citizenship, and hence that the judgment of the circuit court of appeals is final. But one of the defendants (plaintiff in error), though a citizen of a different state from the plaintiff in the action (defendant in error), is also a receiver of a national bank appointed by the comptroller of the currency and is an officer of the United States, and an action against him is one arising under the laws of the United States" (See page 140 of U. S. Rep. for this portion of opinion).

In *Ex parte Chetwood*, 165 U. S. 443, 458, this Honorable Court said:

> "The receiver was not the officer of any court, but the agent and officer of the United States."

Again, in *United States* v. *Weitzel*, 246 U. S. 533, 541, this court asserts the rule:

> "The receiver, unlike a president, director, cashier or teller, is an officer, not of the corporation, but of the United States. * * * As such he gives to the United States a bond for the faithful discharge of his duties; pays to the treasurer of the United States moneys collected; and makes to the comptroller reports of his acts and proceedings. * * * Being an officer of the United States he is represented in court by the United States Attorney for the district, subject to the supervision of the solicitor of the treasury. * * * And because he is such officer, a receiver has been permitted to sue in the federal

court regardless of citizenship or of the amount in controversy."

As previously stated, the duties of a liquidator under the Florida bank law and the duties of a receiver under the national bank act are practically identical. The Florida Supreme Court has termed the liquidator of a state bank an officer of the state, and this Honorable Court has termed the receiver of a national bank an officer of the United States.

It is true that neither takes an oath of office and neither holds office for a definite term. The policy of the State of Florida, as evidenced by statutes and judicial interpretation thereof is to designate a liquidator an officer of the state.

If a liquidator is not an officer of the state, he certainly is an employee; his duties are prescribed by statute, his compensation is fixed within certain limits by statute and he is under the supervision and control of the comptroller. In the supervision of banks by the State of Florida the liquidator is an indispensable officer or employee.

The Board of Tax Appeals ruled that the liquidator is an independent contractor. We do not think the rule sound, as the liquidator cannot enter into a contract with anyone; he certainly cannot enter into a contract with the stockholders or creditors of a state bank to liquidate the same; he cannot enter into a contract with the comptroller because the statute above mentioned defines the manner of his appointment, his duties and his compensation.

Probably no case is quoted more in controversies involving income tax than that of *Metcalf and Eddy* v. *Mitchell*, 269 U. S. 514. The peculiar thing about it is that everyone who quotes from it seems to receive a great deal of satisfaction from said case. The Board of Tax Appeals quoted from it in support of its rule that the respondent was an independent contractor, the Commissioner in the court below also quoted from it; and we also wish to quote from it to show that a liquidator of a Florida bank is not an independent contractor according to the definition therein set forth (page 520):

> "Nor do the facts stated in the bill of exceptions establish that the plaintiffs were 'employees' within the meaning of the statute. So far as appears, they were in the position of independent contractors. The record does not reveal to what extent, if at all, their services were subject to the direction or control of the public board or officers engaging them. In each instance the performance of their contract involved the use of judgment and discretion on their part and they were required to use their best professional skill to bring about the desired result. This permitted to them liberty of action which excludes the idea of that control or right of control by the employer which characterizes the relation of employer and employee and differentiates the employee or servant from the independent contractor."

Other courts have defined an *independent contractor*. We quote from Words and Phrases, First Series, Vol. 4, page 3542:

> "An independent contractor is one who renders service in the course of an occupation, representing the will of his employer only as to the result of his

work, and not as to the means by which it is accomplished. *Gayle* v. *Missouri Car & Foundry Co.*, (Mo.) 76 S. W. 987-992; *Crenshaw* v. *Ullman*, 20 S. W. 1077, 1078, 113 Mo. 633 (citing Thompson on Negligence).

"An independent contractor is one who, exercising an independent employment, contracts to do a piece of work according to his own methods, and without being subject to the control of his employer except as to the result of the work. *Waters* v. *Pioneer Fuel Co.*, 52 Minn. 474, 55 N. W. 52, 38 Am. St. Rep. 564; *Indiana Iron Co.* v. *Cray*, 48 N. E. 803, 807, 19 Ind. App. 565.

"An independent contractor is one who contracts to perform the work at his own risk and cost, the workmen being his servants, and he, and not the person with whom he contracts, being liable for their misconduct. *People* v. *Orange County Road Const. Co.*, 67 N. E. 129, 130, 131, 175 N. Y. 84.

"An independent contractor is said to be one who undertakes to do specific pieces of work for other persons without submitting himself to their control in the details of the work, or one who renders the service in the course of an independent employment, representing the will of his employer only as to the result of his work, and not as to the means by which it is accomplished. *Waters* v. *Pioneer Fuel Co.*, 55 N. W. 52, 52 Minn. 474, 38 Am. St. Rep. 564; *Norfolk & W. Ry. Co.* v. *Stevens' Adm'r*, 34 S. E. 525, 526, 97 Va. 631, 46 L. R. A. 367.

"An independent contractor is one who contracts to perform service for another independent of the employer in all that pertains to the execution of the work, and who is subordinate to the employer only in effecting a result in accordance with the employer's design. *Smith* v. *Simmons*, 103 Pa. 32, 36, 49 Am. Rep. 113."

The wording of the Florida statute negatives any claim that the respondent is an independent contractor. The respondent, "under the direction and supervision of the comptroller," performed his duties, which certainly means that the comptroller supervised the manner in which he performed his duties. The respondent was employed to turn the assets of the closed banks into cash, but he was not free to do it in the manner he thought best but had to follow the comptroller's instructions as to the means employed. Under the Florida statutes, a liquidator of a closed bank cannot assess the stockholders on their statutory liability whenever he thinks it proper to do so, but must wait until directed by the comptroller.

In the case of *Chavous* v. *Gornto,* 89 Fla. 12, 102 So. 755, the Florida Supreme Court, quoting from the case of *Kennedy* v. *Gibson,* 8 Wall. 498, says:

> " 'The receiver is the instrument of the comptroller. He is appointed by the comptroller, and the power of appointment carries with it the power of removal. It is for the comptroller to decide when it is necessary to institute proceedings against the stockholders to enforce their personal liability, and whether the whole or a part, and if only a part, how much, shall be collected. These questions are referred to his judgment and discretion, and his determination is conclusive.' "

The petitioner argues that the respondent was not an employee of the comptroller but rather a contractor who, after his appointment, had substantially the status which the bank whose affairs he was conducting had prior to its insolvency. This argument, we submit, is fallacious, as the respondent did not stand in the shoes

of the officers and directors of the bank prior to its insolvency. This Honorable Court, in *United States* v. *Weitzel* (*supra*), held that the receiver of a national bank was, unlike the president, director, cashier or teller, an officer, not of the corporation, but of the United States. In other words, the receiver represented the United States Government and was not an officer or employee of the insolvent bank.

Again the petitioner argues that because Section 4159 of Revised General Statutes provides that liquidators shall have their books examined the same as a solvent bank, that therefore the respondent is an independent contractor. By the same reasoning, the clerk of the circuit court, the sheriff, the tax collector, the tax assessor, and all state officers, would be independent contractors because their books are audited under the direction of the state auditor.

Section 235, C. G. L., *infra*, p. 29, authorizes the governor of Florida to designate and direct any one or more of the state auditors to audit the office, books and records of any county, of any state or county officer, or of any state institution, board or commission.

Petitioner contends it was most unlikely that the comptroller supervised the respondent beyond directing him what to do, namely, liquidate the institutions. Regardless of what the comptroller did in the instant case, the law is clear that the respondent was under the supervision, direction and control of the comptroller, and the Board of Tax Appeals could not by its decision make the duties of the respondent and the supervision and control of the same contrary to the law of the State of Florida.

II.

The Respondent Was Engaged in an Essential Governmental Function

We doubt if anyone will seriously contend that the supervision of banking is not an essential governmental function.

In the early part of the nineteenth century, this Honorable Court, in the famous case of *M'Culloch* v. *The State of Maryland et al.*, 4 Wheat. 316, asserted that the United States had the constitutional right to incorporate a national bank and to establish branches within any state. This was one of the early cases which prohibited the state from taxing an instrumentality of the Federal Government. Since the above case was decided, the Congress of the United States has from time to time increased its supervision over and control of national banks. It is indispensable to our industry, trade and commerce that this governmental supervision and control be maintained and perhaps increased. The establishment of the Federal Reserve System was for the purpose of preventing panics and enabling our economic life to be maintained without the previous fluctuations of feast and famine. Undoubtedly, the Federal Reserve Act was of great assistance to the commercial life of this country, but the disruption of our banking system during the latter part of 1932 and the forepart of 1933, disclosed that the Federal Reserve Bank System by itself was not sufficient to accomplish the purposes sought. Therefore, Congress passed an act setting up a corporation to insure deposits in national banks; this was done to

strengthen the confidence of the depositors in the various financial institutions and thereby prevent a recurrence of the financial stringency existing during the forepart of 1933.

We are of the opinion that most state governments have recognized that supervision and control of state banks are necessary and essential functions of the state. This has been asserted by decisions from various state courts.

In American and English Annotated Cases, Vol. 10, page 903, is a note covering "State Regulations and Private Banking." We quote from the first paragraph thereof:

> "It seems to be uncontroverted that at common law the right of banking belonged to a citizen individually, and might be exercised by him at pleasure. However, while this is true, the decisions generally recognize the right of the legislature to control and regulate the business of banking, on the theory that under the police power the state may legislate for the protection of its citizens; but until restrained or controlled by legislation the right to engage in the business of banking is absolute. *Augusta Bank* v. *Earle,* 13 Pet. (U. S.) 519; *Nance* v. *Hemphill,* 1 Ala. 551; *People* v. *Utica Ins. Co.,* 2 Johns. Ch. (N. Y.) 371; *People* v. *Utica Ins. Co.,* 15 Johns. (N. Y.) 358; *Perkins* v. *Smith,* 116 N. Y. 441, 23 N. E. Rep. 21. And, see *Ohio L. Ins., etc., Co.* v. *Merchants' Ins., etc., Co.,* 11 Humph. (Tenn.) 1; *State* v. *Williams,* 8 Tex. 255. See, also, *State* v. *Stebbins,* 1 Stew. (Ala.) 299; *People* v. *Bartow,* 6 Cow. (N. Y.) 290."

We also quote from Vol. 7 of American Jurisprudence, Par. 9, page 30:

"Banks are indispensable agencies through which the industry, trade and commerce of all civilized countries and communities are carried on; the business which they transact, though for private profit, is of a preeminently public nature, and is, therefore, universally recognized as a proper subject of legislative regulation under the police power of the state. The power of the legislature in this regard is supreme, subject only to such limitations as are imposed by the fundamental law."

A portion of Paragraph 14, page 34, of the same volume of American Jurisprudence, reads as follows:

"The power of the sovereign authority to provide for the creation of offices and the appointment of officials designated to regulate and supervise the banking business within the jurisdiction of such sovereign authority is well recognized. An instance of this is the appointment of bank examiners for state or national banks. A further instance is the creation of the office of a bank commissioner, superintendent of banks, or other state officer who is invested with the power to take charge of a bank which is deemed to be in unsafe condition; or who is invested with the power to liquidate the bank, or appoint a liquidator, or apply to the court for the appointment of a receiver when the bank is deemed to be insolvent."

The third headnote of *Noble State Bank* v. *Haskill*, 219 U. S. 104, reads as follows:

"The police power of a state extends to the regulation of the banking business, and even to its prohibition except on such conditions as the state may prescribe."

The regulation of the banking business carries with it, not only the regulation of solvent banks, but the or-

derly liquidation of insolvent banks. The widespread closing of banks in Florida in the years 1929, 1930 and 1931, and the almost universal closing of banks in the United States during the year 1932 and the forepart of 1933, demonstrate conclusively that the regulation of banks, including the orderly liquidation of insolvent banks, is a necessary governmental function for the protection of individual depositors and the flow of commerce.

We reiterate that in our opinion no one can successfully argue that the supervision and control of banking are not essential governmental functions, for they have long been recognized by the Federal Government and the various states as essential to the peace, prosperity and convenience of their citizens.

The petitioner admits that the regulation of state banking institutions is an essential governmental function, but denies that the liquidation of state banks is an essential governmental function. He also maintains that because the expenses of liquidation are paid out of the assets and income of the insolvent institutions rather than by appropriation of public funds out of the state treasury, the liquidating of banks is akin to the conduct of a particular business enterprise. Under the Florida statutes, the supervision of solvent banks and the liquidation insolvent banks are placed in the hands of the comptroller. It is all one policy and system; you cannot take it apart and say that one is essentially governmental and the other is not. The federal government takes great care to see that banks are properly liquidated and it is done under the direction of the comp-

troller. The purpose is the same whether the bank be solvent or insolvent, namely, that the money of the citizens of the state and nation be properly protected. Public confidence would be greatly shaken and economic loss would follow if private individuals could make a contract with the directors and officers of an insolvent bank to liquidate the same.

If the payment of the liquidator's compensation from the assets of a closed bank makes the liquidation of that institution a private enterprise, by the same reasoning the payment of bank examiners from the income of solvent banks would make the job of bank examinations a business enterprise and not a governmental function.

The petitioner says that the Florida law permits Federal Deposit Insurance Corporation to liquidate an insolvent state bank, and for this reason the liquidation of banks is not an essential governmental function. We doubt very much if this Honorable Court would say that Federal Deposit Insurance Corporation is not an essential federal instrumentality, for we believe that all courts recognize it as such; it performs an essential governmental duty for the Federal Government. If the State of Florida desires to delegate to said corporation one of the state's essential governmental functions, it has a constitutional right to do so, but the mere delegation does not change the quality of the power delegated. The act delegating the power was not passed until 1937, while the respondent received his compensation in 1931 and 1932.

III.

The Source of the Compensation of Respondent Is Immaterial.

In the court below the petitioner laid great stress upon the fact that the source of respondent's compensation was from the assets of the closed banks; the argument being that the imposition of a tax upon the income of the respondent would not impose a direct burden upon the state. By "burden," we assume the petitioner means financial burden. We do not think the argument sound, for that is not the criterion applied under the decided cases.

For instance, in the State of Florida the clerk of the circuit court receives his compensation from fees collected from those having instruments recorded and others engaged in litigation. The litigants may be from states other than Florida and it is a well-known fact that much land is owned by residents of other states who pay the clerk of the court for recording their deeds (*infra*, p. 32). There are a great many other instances in the State of Florida where officers and employees are paid from fees not realized by general taxation. The state has seen fit to require in certain instances the recipient of a state service to pay a fee for said service; yet if the officers or employees receiving their compensations by means of fees rather than from general taxation should be taxed by the Federal Government, it would be an interference with an instrumentality of government. We therefore believe that the true test is whether the respondent is an officer or employee of the state engaged in an essential governmental function. We further believe that

where the phrase, "burden on the state," is used, as in some of the reported cases, it refers to an interference with state governmental instrumentalities rather than to any tax burden. In other words, if a person is an officer or employee of the state engaged in an essential governmental function, any attempt by the Federal Government to tax his compensation is an interference with the constitutional powers of the state, regardless of whether the compensation of such officer or employee is paid from general taxation funds or from fees collected by the state for services performed by its officers or employees.

> "This principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. * * * Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute."
>
> *Indian Motorcycle Company* v. *United States of America*, 283 U. S. 570.

In the case of *Western Union Telegraph Company* v. *Texas*, 105 U. S. 460, this Honorable Court held that a state excise on the transmission of telegrams was void as to messages sent by officers of the United States on public business, because the excise, although exacted only of the telegraph company, was, so far as it was based on government messages, a tax on the means employed by the United States in carrying its constitutional powers into effect.

In *Ambrosini* v. *United States,* 187 U. S. 1, this Honorable Court decided that bonds exacted by a municipal corporation of the State of Illinois as a condition to granting liquor licenses the issue of which was committed by the state to the municipal corporation could not be taxed by the United States, even though the tax was collected only from the licensees, because such a tax would burden the exercise of a function belonging to the State of Illinois and the municipal corporation in their governmental capacity.

The case of *Burnet* v. *Coronado Oil & Gas Company,* 285 U. S. 393, sustains the principle for which we contend. In that case the State of Oklahoma leased certain state lands to Coronado Oil & Gas Company, the revenue from which was used by the state for educational purposes. The lessee sold the oil and gas, but claimed exemption from income tax on the money received from said sales. This Honorable Court held that the maintenance of her schools by the State of Oklahoma was a governmental function and that to tax the lessee on income from the sale of the gas and oil would be an interference by the Federal Government with a state governmental function. We quote from pages 400 and 401 of the opinion:

> "Here the lease to the respondent was an instrumentality of the state for the purpose of carrying out her duty in respect to public schools. To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself."

In the above case there was no money burden upon the State of Oklahoma, for it received the rental pro-

vided by the lease, but there was, nevertheless, an interference with an instrumentality of the state. It can be argued that if the lessee had had to pay income tax it would have paid less to Oklahoma for the lease, thereby causing a monetary burden upon the state. It can be just as logically argued in the instant case that if bank liquidators are compelled to pay income tax on their compensation, the State of Florida might have to supplement the liquidators' compensation with money derived from general taxation.

In the recent case of *Brush* v. *Commissioner of Internal Revenue*, 300 U. S. 352, the salary of the chief engineer of the Bureau of Water Supply of the City of New York was held exempt from federal taxation. Although the case does not so state, undoubtedly the salary was paid out of receipts secured from the citizens of New York City from the sale of water and not from general taxation. No mention is made as to the source of the engineer's salary, but it is decided squarely upon the point that the water system of New York is conducted in the exercise of the city's governmental functions and that therefore fixed salaries and compensation paid to its officers and employees are immune from federal taxation.

> "Thus, the employment of officers who are agents to administer its laws (*Collector* v. *Day, supra*; *Dobbins* v. *Erie County*, 16 Pet. 435, 10 L. Ed. 1022), its obligations sold to raise public funds (*Weston* v. *Charleston*, 2 Pet. 449, 467, 7 L. Ed. 481, 487; *Pollock* v. *Farmers' Loan & T. Co.*, 157 U. S. 429, 585, 586, 39 L. Ed. 759, 820, 821, 15 Sup. Ct. Rep. 673), its invest-

ments of public funds in the securities of private corporations, for public purposes (*United States* v. *Baltimore & O. R. Co.*, 17 Wall. 322, 21 L. Ed. 597), surety bonds exacted by it in the exercise of its police power (*Ambrosini* v. *United States*, 187 U. S. 1, 47 L. Ed. 49, 23 Sup. Ct. Rep. 1, 12 Am. Crim. Rep. 699), are all so intimately connected with the necessary functions of government, as to fall within the established exemption; and when the instrumentality is of that character, the immunity extends not only to the instrumentality itself but to income derived from it (*Pollock* v. *Farmers' Loan & T. Co.*, and *Gillespie* v. *Oklahoma*, *supra*) and forbids an occupation tax imposed on its use (*Choctaw, O. & G. R. Co.* v. *Harrison*, 235 U. S. 292, 59 L. Ed. 234, 35 Sup. Ct. Rep. 27; and see *Dobbins* v. *Erie County*, *supra*)."

Metcalf and Eddy v. *Mitchell* (*supra*).

Section 6101, C. G. L. of Fla. Supp. (*infra*, p. 31), provides for the assessment of each state bank examined by a state bank examiner. This money is put into the state treasury and the bank examiner is paid by a warrant drawn by the comptroller on the state treasurer.

See Section 6100, C. G. L. of Fla. Supp. (*infra*, p. 30).

The bank examiners are therefore paid by assessment upon the banks examined. In the case of insolvent banks, an assessment is made upon the assets of the insolvent banks to pay the cost of liquidation. All collections made by liquidators are put into the state treasury and kept in a spe-

cial fund. The liquidator is paid by warrant of the comptroller drawn on the state treasurer. The source of the bank examiner's compensation is from solvent banks and is no financial burden upon the state. We doubt, however, if the compensation of state bank examiners is taxed by the Federal Government. National bank examiners are paid in the same manner and we doubt if any state attempts to collect an income tax from a national bank examiner.

In the case of *People of the State of New York* v. *Graves*, 299 U. S. 401, the compensation of the general counsel for the Panama Railroad Company was held exempt from taxation by the State of New York on the ground that the Panama Railroad Company was a wholly owned instrumentality of the United States, engaged in maintaining, operating and protecting the Panama Canal. The railroad company utilized its ships and railroad to carry private freight and passengers; it also maintained a dairy and hotels and therefore had an income. No point is made as to whether the compensation was paid from general taxation or from the receipts of the railroad company; the decision was placed squarely upon the ground that the attorney was an officer or employee of an essential governmental instrumentality.

In the case of *Mallory* v. *White*, 8 Fed. Supp. 989, the compensation of a pathologist in Boston City Hospital, who was subject to the control of hospital trustees and whose salary was paid by the city, was held not subject to federal income tax as he was an employee of the city.

In that case part of the expenses of running and maintaining the hospital were paid from money received from pay patients.

In *Commissioner of Internal Revenue* v. *Ten Eyck*, 76 F. (2d) 515, the salary of the chairman of Albany Port District Commission was held exempt from federal income tax on the ground that he was an officer or employee of the State of New York engaged in an essential governmental function. The opinion does not state the source of the chairman's salary, but undoubtedly it was paid from fees charged by Albany Port District Commission for the use of the port. In the instant case respondent's compensation was paid from fees or taxes levied by the State of Florida upon the assets of the insolvent banks which the respondent liquidated.

We think the true rule as extracted from the many decisions of this Honorable Court involving taxation by the Federal Government is that a truly state governmental function or instrumentality cannot be interfered with by taxing the income of the officer or employee performing said function or making said instrumentality effective. A tax upon the performer of an essential governmental function is in reality a tax upon the function.

IV.

Article 643 of Treasury Regulations 74 and Article 643 of Treasury Regulations 77 Show Administrative Recognition of the Respondent's Contention.

While a treasury regulation cannot give exemption where none exists without it and cannot take away an exemption otherwise existing, it is nonetheless true that administrative recognition of a particular claimed exemption is sometimes very persuasive of the propriety

of the exemption. We must submit that Article 643 of Treasury Regulations 74 and 77 is an administrative interpretation of the income tax law which coincides with the claim of the respondent. Said article provides that compensation paid to state officers and employees by a state for services rendered in connection with the exercise of an essential governmental function of the state are not taxable. Said article defines an officer as one who occupies a position in the service of the state, the tenure of which is continuous and not temporary and the duties of which are prescribed by law and regulations and not by agreement. The same article defines an employee as one whose duties consist in the rendition of prescribed services and not in the accomplishment of specific objects, and whose services are continuous, not occasional or temporary.

The respondent in this case was paid by the State of Florida by vouchers signed by the comptroller and the treasurer; he occupied a position in the service of the state; his duties were prescribed by statute and we do not think that said duties were temporary. He was appointed in 1930, and devoted all of his time to his office, with the exception of attending an occasional directors' meeting of a bank in Ocala, Florida, until the end of 1932.

CONCLUSION.

The record and the cases heretofore cited show that respondent was an officer or employee of the State of Florida engaged in an essential governmental function. This being true, it is immaterial from what fund his compensation was paid, so long as it was paid by the State of Florida. Therefore the decision of the United States Circuit Court of Appeals should be affirmed.

Respectfully submitted,

H. M. VOORHIS,
Attorney for Respondent.

December, 1937.

APPENDIX.

6102. (4162.) COMPTROLLER MAY APPOINT LIQUIDATOR; DUTIES OF LIQUIDATOR; NOTICE TO BANK OFFICERS; CONFIRMING APPOINTMENT.—On becoming satisfied, from the reports furnished to him by a State bank examiner, or upon other satisfactory evidence thereof, that any bank, banking firm, banker, banking or trust company, or corporation doing business in this State under the State laws, has become insolvent and is in default, or that the affairs of any bank, banker, banking firm or trust company or corporation doing business in this State, under such State laws, is in an unsound condition, or threatened with insolvency because of illegal or unsafe investments, or that its liabilities exceed its assets, or that it is transacting business without authority of law or in violation of law, or if the directors of any bank, banking or trust company, or corporation, or any banker or the management of any banking firm doing business in this State under the State laws, shall knowingly violate, or knowingly permit any of its officers, agents, or servants to violate any of the provisions of law relative to such bank, bankers, banking firms, banking or trust companies, or corporations doing business in this State, the rights, privileges and franchises shall be subject to be forfeited, and the State Comptroller may in his discretion forthwith designate and appoint a liquidator to take charge of the assets and affairs of such bank, and require of him such bond and security as the

Comptroller deems proper, not exceeding double the amount that may come into his hands, and such liquidator shall be subject to dismissal by the Comptroller, whenever in his judgment such dismissal is deemed necessary or advisable; when one liquidator is dismissed, another may be duly designated and appointed. Such liquidator under the direction and supervision of the Comptroller, shall take possession of the books, records and assets of every description of such bank, banker, banking firm, banking and trust company, or corporation, and in his name shall sue for and collect all debts, dues and claims belonging to it, and upon the order of a court of competent jurisdiction may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such bank, bankers, banking firm, banking and trust company, or corporation, on such terms as the court shall direct; and may, if necessary, to pay the debts of such bank, banker, banking firm, banking and trust company, or corporation, sue for and enforce the individual liability of the stockholders. Such liquidator shall pay all money received by him to the State Treasurer to be held as a special deposit for the use and benefit of the creditors, subject to the order of the Comptroller, and shall also make quarterly reports to or when called upon, to the Comptroller of all of his acts and proceedings. The Comptroller, immediately upon appointing such liquidator, shall serve notice upon the president, or upon any vice president or cashier, or upon any director or other person having the charge or management of any such bank,

banker, banking firm, banking or trust company, or corporation, informing him or them in such notice of his action in appointing such liquidator, and notifying him or them or it that he would apply on a date therein named, not to exceed ten days from the date of service of such notice, to some circuit judge having jurisdiction over the same, for an order confirming his action and the appointment of a liquidator for such banking institution and such bank, banking firm, or banking or trust company, or corporation may, at such hearing, contest before such circuit judge the rightfulness and legality of such action of the Comptroller in appointing such liquidator. (Ch. 6807, Acts May 27, 1915, Par. 1; Ch. 13576, Acts 1929, Par. 19), C. G. L., Florida Supp.

6105. (4164) EXPENSES OF LIQUIDATION; COMPENSATION OF LIQUIDATORS; DISPOSITION OF BANK'S FUNDS.—All expenses of any liquidation shall be paid out of the assets of such bank, banker, banking firm, banking or trust company, or corporation, before distribution of the proceeds thereof. The compensation of the liquidator shall be fixed by the Comptroller, and shall be based upon the amount of work actually necessary and performed, and shall in no case exceed five per cent. of the cash collections. From time to time, after full provisions having first been made for the expenses of the liquidating agency, and the payment of liens for taxes and preferred claims, the Comptroller shall make ratable dividend of the money in the hands of the State Treasurer on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and as the proceeds of the assets of such bank, banker, banking

firm, banking or trust company, or corporation, are paid over to the liquidator, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, after all claims have been paid, shall be paid over to the shareholders, of such bank, banker, banking firm, banking or trust company, or corporation, or their legal representatives in proportion to the stock by them respectively held, or their interest therein as appearing. (Ch. 6807, Acts May 27, 1915, Par. 3; Ch. 13576, Acts 1929, Par. 21), C. G. L., Florida Supp.

6107. (4166) LIQUIDATORS UNDER SUPERVISION OF COMPTROLLER.—The provisions of this Article shall apply to all receivers of any bank, banking firm, or banking or trust company, heretofore appointed by the order of any circuit court, and all such receivers, both those hereunder and those heretofore appointed by the Circuit Court, shall at all times be under the supervision and control of the Comptroller, and subject at all times to summary discharge and dismissal by him and any vacancy in such receivership may be filed by the Comptroller at any time. (Ch. 6807, Acts May 27, 1915, Par. 6; Ch. 13576, Acts 1929, Par. 23), C. G. L., Florida Supp.

191. GENERAL GROUNDS FOR APPOINTMENT OF RECEIVER.—Whenever any national banking association shall be dissolved, and its rights, privileges, and franchises declared forfeited, as prescribed in Section 94, or whenever any creditor of any national banking association shall have obtained a judgment against it in any court of record, and made application, accompanied by a cer-

tificate from the clerk of the court stating that such judgment has been rendered and has remained unpaid for the space of thirty days, or whenever the comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs, in either case, appoint a receiver who shall proceed to close up such association, and enforce the personal liability of the shareholders, as provided in Section 192 (June 30, 1876, c. 156, Par. 1, 19 Stat. 63) Title 12, USCA.

192. DEFAULT IN PAYMENT OF CIRCULATING NOTES.— * * * Such receiver, under the direction of the comptroller shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders. Such receiver shall pay over all money so made to the Treasurer of the United States, subject to the order of the comptroller, and also make report to the comptroller of all his acts and proceedings. Title 12, USCA.

235. AUTHORITY OF GOVERNOR TO DIRECT MAKING OF AUDIT. EMPLOYMENT OF EXTRA ACCOUNTANTS.—The Governor shall have and is hereby given the authority, when in his judgment it shall be necessary, to designate and direct any one or more of the auditors provided for in this Article to audit the office, books and records of any

county, of any State or county officer, or of any State institution, board or commission. The Governor shall also have the power and authority, if in his judgment it shall become necessary, to employ not exceeding two expert and efficient accountants, in addition to the auditors provided for in this Article, to make a special audit of any State department, State or county office, State institution, board or commission. Such additional or emergency auditors or accountants shall receive such compensation as shall be agreed on before the service is performed. (Ch. 12279, Acts 1927, Ch. 9.) C. G. L. of Florida, 1927.

6100. (4160.) COMPENSATION AND TRAVELING EXPENSES OF EXAMINERS.—The person employed by the Comptroller as bank-report analyst shall receive compensation at the rate of three thousand eight hundred dollars per annum; chief bank examiner, three thousand two hundred fifty dollars per annum and every other person employed by the Comptroller as bank examiner shall receive compensation at the rate of three thousand dollars per annum, and actual traveling expenses, while in the discharge of their duties. The Comptroller shall audit the accounts for traveling expenses of such examiners incurred in the discharge of such duties and shall draw his warrants on the State Treasurer for the amount due for such salaries in monthly payments and the expenses in monthly payments, and the warrants so drawn shall be paid by the State Treasurer, and an amount sufficient to pay such warrants for salaries and expenses is hereby appropriated. (Ch. 5687, May 29, 1907, Par. 2;

Ch. 6427, June 7, 1913, Par. 2; Ch. 10037, Acts 1925, Par. 2; Ch. 13576, Acts 1929, Par. 15; Ch. 15720, Acts 1931, Extra. Sess., Par. 1.). C. G. L., Florida, Supp.

6101. (4161) EXAMINATIONS OF BANKS AND TRUST COMPANIES; EXAMINATION FEES.—Each bank, banking firm, banking company, trust company and liquidating agency, doing business in the State of Florida, except national banks, shall be examined at least twice in each year by the State Comptroller or his agent, and oftener if deemed necessary: Provided however, that the State Comptroller may accept in his discretion in lieu of an examination authorized by the laws of this State a copy of the examination report that may have been made within a reasonable period by the Federal Deposit Insurance Corporation: and Provided further that the State Comptroller may furnish to the Federal Deposit Insurance Corporation or its representative a copy of all examinations made of any such banking institutions, and for each examination so made by the State Comptroller each bank, banker, banking firm, banking company, or trust company shall pay into the State treasury an examination fee based upon the resources of each bank or trust company as follows:

With resources up to one hundred fifty thousand dollars, twenty dollars.

With resources up to two hundred fifty thousand dollars, twenty-five dollars.

With resources up to four hundred thousand dollars, forty dollars.

With resources up to five hundred thousand dollars, fifty dollars.

With resources up to seven hundred fifty thousand dollars, seventy-five dollars.

With resources up to one million dollars, one hundred dollars.

And for each additional million or major part thereof, twenty-five dollars per million.

Examination fees shall in all cases be paid by the bank, banker, banking firm, banking or trust company, direct to the State Treasurer.

Within thirty days after each such examination made by the Comptroller, the Comptroller shall notify the bank, banker, banking firm, banking or trust company, so examined and the State Treasurer of the amount due in each case and if such examination fees are not paid within sixty days after such notification, the State Treasurer shall report to the Comptroller, and the bank, banker, banking firm, banking company or trust company, so failing to pay each such examination fee shall then be held and deemed to be in default of section 6102 (Ch. 5687, May 29, 1907, Par. 6; Ch. 6427, June 7, 1913, Sec. 1; Ch. 10037, Acts 1925, Par. 3; Ch. 13576, Acts 1929, Par. 16; Ch. 16795, Acts 1935, Par. 1), C. G. L., Florida Supp.

4867. (3084.) As Clerk or Recorder.—The compensation of the clerk of the various courts of records and the clerks of the circuit court as recorder shall be entirely by fees and shall be as follows:

Arraignment of prisoner	$ .25
Appearance of defendant, entering	.15
Attachment, issuing	.50
Attachment for witnesses	.50

Bond, approving	1.00
Capias, issuing	.75
Certiorari, issuing	.75
Commission to take testimony, issuing	1.00
Commissioners, instruction to, issuing	.50
Copying any record or paper, first one hundred words	.25
Each additional one hundred words and fraction thereof	.12½
Costs, taxing	.25
Deed, taking acknowledgment of	.50
Docketing cases in bench or bar dockets at each term, each	.15
Dower, taking relinquishment of	.50
Entering other matters required in the records of courts (except as herein otherwise provided), for the first one hundred words or less	25, etc.

CLERK'S COPY

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 129

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILLIAM H. TUNNICLIFFE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 8, 1937
CERTIORARI GRANTED OCTOBER 11, 1937

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 129

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VS.

WILLIAM H. TUNNICLIFFE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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TRANSCRIPT OF RECORD.

UNITED STATES CIRCUIT COURT OF APPEALS
FIFTH CIRCUIT.

WILLIAM H. TUNNICLIFFE,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition to Review the Decision of the United States Board of Tax Appeals.

DOCKET No. 78714.

William H. Tunnicliffe, Petitioner,
vs.
Commissioner of Internal Revenue, Respondent.

Appearances:
For petitioner: H. M. Voorhis, Esq.
For Respondent: C. A. Ray, Esq.

DOCKET ENTRIES:

1935
Mar. 8—Petition received and filed. Taxpayer notified. (Fee paid.)
Mar. 8—Copy of petition served on General Counsel.

May 6—Answer filed by General Counsel.
May 10—Copy of answer served on taxpayer.
May 20—Motion for circuit hearing at Orlando filed by taxpayer. 5/21/35 granted.
May 20—Notice of appearance of H. M. Voorhis as counsel filed.
Dec. 17—Hearing set week of Feb. 24, 1935, Jacksonville, Florida.

1936

Feb. 24—Hearing had before Mr. Smith on merits—submitted. Amendment to petition allowed — amendment to petition filed — copies served. Petitioner's brief due 3/23/36—respondent's brief due 4/8/36—petitioner's reply April 23, 1936.
Mar. 19—Transcript of hearing of Feb. 24, 1936 filed.
Mar. 23—Brief filed by taxpayer. 3/23/36 copy served on General Counsel.
Mar. 30—Motion to correct transcript filed by General Counsel. 3/31/36 granted.
Apr. 27—Motion for leave to file reply brief—reply brief lodged—filed by General Counsel. 4/28/36 granted.
May 13—Reply brief filed by taxpayer. 5/13/36 copy served on General Counsel.
June 10—Memorandum opinion rendered—Charles P. Smith, Division 5. Judgment will be entered for the respondent.
June 10—Decision entered—Charles P. Smith, Division 5.
Aug. 31—Petition for review by U. S. Circuit Court of Appeals, 5th Circuit, with assignments of error filed by taxpayer.
Aug. 31—Affidavit of service of petition for review filed.
Oct. 2—Praecipe filed—affidavit of service attached.

2 PETITION.

Filed March 8, 1935.

United States Board of Tax Appeals.

William H. Tunnicliffe, Petitioner,
vs. Docket No. 78714
Commissioner of Internal Revenue, Respondent.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency, IT:AR:C-2:GLG-90 D, dated December 10th, 1934, and as a basis of his proceeding, alleges as follows:

1. The petitioner is an individual whose residence and address are Sanford, Florida. The petitioner's name, as given in the Notice of Deficiency sent by the Commissioner of Internal Revenue was W. H. Tunnicliffe. This petitioner, William H. Tunnicliffe is the same person as W. H. Tunnicliffe.

2. The Notice of Deficiency, a copy of which is attached hereto and marked, "Exhibit A," was mailed to the petitioner on the 10th day of December, 1934.

3. The taxes in controversy are income taxes for the calendar years 1931 and 1932, and for Two Thousand Seven Hundred Twenty-three and 78/100 ($2,723.78) Dollars.

4. The determination of taxes set forth in the said Notice of Deficiency is based upon the following errors:

A. That the Commissioner erred in determining that the petitioner was neither an officer nor an employee of the State of Florida for the years 1931 and 1932.

3 B. That the Commissioner erred in determining that petitioner's income on which deficiency tax was assessed for the year 1932 was earned and accrued during the year 1932.

C. That the Commissioner erred in determining that petitioner's income for the year 1932, upon which deficiency is assessed, has been held to belong to the petitioner in the suit instituted by the Comptroller of the State of Florida to compel the re-payment of said income.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

A. That the petitioner was appointed liquidator of the State Bank of Orlando & Trust Company, Orlando, Florida in the fore part of 1930; that he was appointed Liquidator for the Orlando Bank & Trust Company, Orlando, Florida in July of 1930; that he was appointed Liquidator of the Bank of Winter Park in July, 1930, under the provisions of Chapter 13,576, Laws of Florida, 1929, which Chapter prescribes the duties and compensation of a liquidator; that Section 19 of said Chapter provides, among other things, that the liquidator under the direction and supervision of the Comptroller shall take possession of the books, records and assets of every director of such bank, banker, banking firm, banking and trust company or corporation and in his name shall sue for and collect all debts, dues and claims belonging to it, and upon the order of a Court of competent jurisdiction, may sell and compound all bad or doubtful debts and sell all the real and personal property of the bank; that Section 21 of said Chapter provides, among other things, that the expenses of the liquidator shall be paid out of the assets of the bank

upon the distribution of the proceeds thereof,
4 and the compensation of the liquidator shall be fixed by the Comptroller, and shall be based upon the work actually necessary and performed, and shall in no case exceed five per cent of the cash collections; that Section 23 of said Chapter provides that the liquidator shall at all times be under the supervision and control of the Comptroller and subject at all times to summary, discharge and dismissal.

B. That during the years 1930, 1931 and 1932 he performed the duties of liquidator for the aforesaid banks and a few other small banks in Central Florida; that at stated intervals, he would remit to the State Treasurer of Florida, moneys received by him which were deposited by the said State Treasurer in a special deposit, for the use and benefit of the creditors of the bank for which the petitioner collected said moneys, which said special deposits were subject to the order of the Comptroller; that the petitioner, during the years 1930, 1931 and 1932 received from the Comptroller each month, certain stated sums, which monthly payments were not based upon the amount of money collected and remitted by the petitioner, but were more in the nature of a drawing account; that in the latter part of 1932, when the Comptroller of the State of Florida knew that his term of office would expire December 31st, 1932, he made a settlement with the petitioner for his services during the years 1930, 1931 and 1932, as liquidator of the aforesaid banks and several small banks in Central Florida, said money being paid from the aforesaid special deposits of the various banks; that while said payment was made in 1932, it was earned by the petitioner during 1930, 1931 and 1932, and said money was on deposit with the State Treasurer of Florida in the aforesaid special funds or deposits during that period of time.

C. That the present Comptroller of the State of Florida, to-wit, J. M. Lee, is suing the petitioner in

the Circuit Court in and for Leon County,
5 Florida at the present time on the ground that the petitioner was a general liquidator under Chapter 13,576, General Laws of Florida, 1929, and therefore confined to a salary of $6,000.00 per year; that said suit has not been terminated, but should it terminate favorably to the Comptroller, the petitioner will be compelled to return all money above $6,000.00 received by him in the year 1932, or suffer a judgment against him.

Wherefore, the petitioner prays that this Board may hear the proceeding and enter an order declaring the aforesaid assessments of deficiency illegal, null and void, and not authorized by the facts in this proceeding, nor the law applicable thereto.

WILLIAM H. TUNNICLIFFE,
Sanford, Florida.

State of Florida,
County of Orange:

William H. Tunnicliffe, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition and is familiar with the statements contained therein, and that the facts stated are true.

WILLIAM H. TUNNICLIFFE.

Subscribed and sworn to before me, this 6th day of March, A. D. 1935.

MARY B. HUFFAKER,
Notary Public, State of Florida at Large.
(Seal)
My commission expires: 3-21-38.

6 EXHIBIT "A."

SN-A

IT:AR:C-2
GLG:90D

Dec. 10, 1934.

Mr. W. H. Tunnicliffe,
Sanford, Florida.

Sir:

You are advised that the determination of your income tax liability for the year(s) 1931 and 1932, discloses a deficiency of $2,723.78 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING,
Commissioner,
(Signed) CHAS. T. RUSSELL.
Deputy Commissioner.

Enclosures:
Statement,
Form 870.

GLG;CC-1
1050M

7 STATEMENT.

IT:AR:C-2
GLG:90D

In Re: Mr. W. H. Tunnicliffe,
Sanford, Florida.

Income Tax Liability.

Years	Income Tax Liability	Income Tax Assessed	Deficiency
1931	$ 34.66	None	$ 34.66
1932	2,689.12	None	2,689.12
Totals	$2,723.78	None	$2,723.78

The reports of the internal revenue agent in charge at Jacksonville, Florida, copies of which were mailed to you, have been reviewed and approved by this office.

Careful consideration has been accorded your protest dated February 17, 1934, in connection with the findings of the examining officer; the information submitted at a conference held in the office of the internal revenue agent in charge on March 15, 1934; the further data contained in your protest dated September 17, 1934 forwarded to the agent's office in reply to Bureau letter of August 17, 1934; and the data submitted at the conference held in the agent's office on October 23, 1934.

You contend that the salaries of $5,833.33 and $25,237.36 received by you for the years 1931 and 1932, respectively, as Florida state bank liquidator are exempt from Federal income tax, and further, that if it is held that your compensation as a state bank liquidator is subject to Federal income tax, you are not liable for tax in an amount in excess of $6,000.00 per annum.

The Laws of Florida 1929, CH. 13576, section 19, amends section 4162, Compiled General Laws of Florida to provide that on becoming satisfied of the insolvency, unsoundness, or irregular activities of a State bank, the State Comptroller may, in his discretion, designate and appoint a liquidator to take charge of the assets and affairs of such bank and require him to give bond, and may dismiss him whenever he deems it necessary or advisable. Such liquidator is under the direction and supervision of the Comptroller.

Section 20 provides that the Comptroller
8 may provide for the administration of the affairs of institutions under the above section, by one general liquidator who shall be designated by the Comptroller as General Liquidator for several or all of the institutions in liquidation, whose compensation shall be paid by the Comptroller, to be paid in such proportions out of the assets of the institution whose affairs are being administered as the Comptroller may determine, not exceeding in the aggregate $6,000.00 per annum.

Section 21 provides that all expenses of any liquidator shall be paid out of the assets of such bank; that the compensation of the liquidator shall be fixed by the Comptroller and shall be based upon the amount of work actually necessary and performed and shall in no case exceed 5 per cent of the cash collections.

Information on file in this office indicates that during 1927 and subsequent years, you were from time to time appointed liquidator of a number of institutions. For your services in 1931, you received $5,833.33 and in 1932, $25,237.36. You were required to give bond as provided by the statute, but took no oath of office. Your compensation was paid by State warrants signed by the State Comptroller and State Treasurer, but such warrants were, apparently, drawn against a special fund created by the deposit of collections made by you.

Reference is made to article 643 of Regulations 77, and to Assistant General Counsel Memorandum 13488

published in Internal Revenue Bulletin Volume XIII, #35, dated August 27, 1934. This Memorandum provides that the compensation of a taxpayer who was designated and appointed by the State Comptroller of Florida as liquidator of each bank which he liquidated, is subject to Federal income tax. This ruling appears to exactly cover your case, and in accordance, therewith, your compensation received as state liquidator is subject to Federal income tax.

You state that the present Comptroller of the State of Florida is suing you on the ground that you were a general liquidator and therefore confined to a salary of $6,000.00, and that if the suit should terminate in favor of the Comptroller, you would be compelled to return all money in excess of $6,000.00 received by you in 1932, as state liquidator.

9 Information on file indicates that you are denying your liability for any damages or your liability to repay any amount received by you as compensation as a state bank liquidator; that there are now pending in the State Courts other suits similar to the suit which has been filed against you; and that no decision in any of these suits has yet been rendered.

Reference is made to Court Decision 499 published in Cumulative Bulletin XI-1, June, 1932, pg. 293, in which it was held that if a taxpayer receives earnings under a claim of right and without restrictions as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

See also the decision of the United States Board of Tax Appeals, in the case of R. A. Rowan and Company, published in Volume 13, B. T. A., page 975.

In view of the above, it is held that amounts received by you for compensation as state bank liquidator are subject to income tax.

A synopsis of your returns as corrected follows:

1931

Computation of Tax.

Net income reported on return		$1,122.38
Add:		
1. Fees for services as liquidator of state banks		5,833.33
Total		6,955.71
Deduct:		
2. Interest on Liberty Bonds eliminated		85.00
Total net income adjusted		$6,870.71
Less:		
Dividends	$ 477.00	
Personal exemption	3,500.00	
		3,977.00
Net income subject to normal tax		$2,893.71
10 Normal tax at 1½% on $2,893.71		43.41
Less:		
Earned income credit		8.75
Tax Liability		$ 34.66
Tax previously assessed		None
Deficiency		$ 34.66

Computation of Earned Income Credit.

Earned net income	$5,833.33

Less:	
Personal exemption	3,500.00
Income subject to normal tax	$2,333.33
Normal tax at 1½% on $2,333.33	35.00
Credit of 25%	8.75

Explanation of Changes.

1. The inclusion of salary of $5,833.33 has been full explained above.

2. The amount of $85.00 reported on your return as interest from Liberty Bonds has been eliminated, inasmuch as this amount is not in excess of the exemption allowed for such interest.

1932

Computation of Tax.

Net income reported on return		$ 1,037.53
Add:		
1. Fees for services as liquidator of state banks		25,237.36
Total		26,274.89
Deduct:		
2. Liberty Bond interest eliminated		85.00
Total net income adjusted		$26,189.89
Less:		
Dividends	$ 587.00	
Personal exemption	2,500.00	
		3,087.00
Net income subject to normal tax		$23,102.89

Normal tax at 4% on $4,000.00	160.00
Normal tax at 8% on $19,102.89	1,528.23
Surtax on $26,189.89	1,000.89
Total tax liability	2,689.12
Tax previously assessed	None
Deficiency	$ 2,689.12

Explanation of Changes.

1. The inclusion in your taxable income of $25,237.36 represents the salary received by you as state bank liquidator and has been previously explained above.

2. Liberty Bond interest of $85.00 has been eliminated from your taxable income as explained for the year 1931.

A copy of this letter has been mailed to Mr. H. M. Voorhis, Orlando, Florida, in accordance with the authorization contained in your power of attorney running to him which is on file in this office.

GLG/CC-1

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12 ANSWER.

Received May 6, 1935.

Filed May 6, 1935.

(Title Omitted.)

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for

the Bureau of Internal Revenue, for answer to the petition filed by the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies the errors alleged in Paragraph 4, subparagraphs A, B and C of the petition.

5. Denies the allegations of fact set forth in subparagraphs A, B, and C of Paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's petition be denied.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel for the Bureau of Internal Revenue.

Of counsel:
GEORGE D. BRABSON,
V. F. WEEKLEY,
Special Attorneys, Bureau of Internal Revenue.

VFW/nc 5/4/35

13 AMENDMENT TO PETITION.

Filed at Hearing, Feb. 24, 1936.

(Title Omitted.)

Comes now the Petitioner, after receiving permission from the United States Board of Tax Appeals, and amends subparagraph "A" of paragraph numbered 4 so that it will read as follows, to-wit:

"That the Commissioner erred in determining that the petitioner was neither an officer nor an employee of the State of Florida, engaged in the exercise of an essential governmental function during the years 1931 and 1932."

H. M. VOORHIS,
Attorney for William H. Tunnicliffe, the Petitioner.

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14 MEMORANDUM OPINION.

United States Board of Tax Appeals.

William H. Tunnicliffe, Petitioner,
v. Docket No. 78714.
Commissioner of Internal Revenue, Respondent.

H. M. Voorhis, Esq., for the petitioner.
C. A. Ray, Esq., for the respondent.

SMITH: This proceeding involves deficiencies in petitioner's income tax for 1931 and 1932 in the amounts of $34.66 and $2,689.12, respectively. The deficiencies for both years result from the addition to the petitioner's gross incomes of certain amounts received by

him in those years as compensation for his services as liquidator of several banks in the State of Florida. Whether this compensation is taxable to the petitioner in the years when received or whether it is exempt from taxation on constitutional grounds is the only question in issue in this proceeding.

In 1930 the petitioner was appointed liquidator of eleven banks in central Florida. The appointments were all made by the State Comptroller pursuant to section 19 of chapter 13576 of the General Laws of Florida (1929). The section of the statute referred to reads in material part as follows:

"On becoming satisfied, from the reports furnished to him by a State Bank Examiner, or upon other satisfactory evidence thereof, that any bank, banking firm, banker, banking or trust company, or corporation doing business in this State under the State laws, has become insolvent and is in default * * *, the State Comptroller may in his discretion forthwith designate and appoint a liquidator to the charge of the assets and affairs of such bank, and require of him such bond and security as the Comptroller deems proper, not exceeding double the amount that may come into his hands, and such liquidator shall be subject to dismissal by the Comptroller, whenever in his judgment such dismissal is deemed necessary or advisable; when one liquidator is dismissed, another may be duly designated and appointed. Such liquidator under the direction and supervision of the Comptroller, shall take possession of the books, records and assets of every description of such bank, banker, banking firm, banking and trust company, or corporation, and in his name shall sue for and collect all debts, dues and claims belonging to it, and upon the order of a Court of competent jurisdiction may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such bank, banker, banking firm, banking

and trust company, or corporation, on such terms as the Court shall direct; * * * Such liquidator shall pay all money received by him to the State Treasurer to be held as a special deposit for the use and benefit of the creditors, subject to the order of the Comptroller, and shall also make quarterly reports to or when called upon, to the Comptroller of all of his acts and proceedings."

Section 21 of the statute provides that—

"All expenses of any liquidator shall be paid out of the assets of such bank, banker, banking firm, banking or trust company, or corporation before distribution of the proceeds thereof. The compensation of the liquidator shall be fixed by the Comptroller, and shall be based upon the amount of work actually necessary and performed, and shall in no case exceed five per cent of the cash collections."

16 Section 23 of the statute provides that—

"The provisions of this Act shall apply to all receivers of any bank, banking firm, or banking or trust company, heretofore appointed by the order of any Circuit Court, and all such receivers, both these hereunder and those heretofore appointed by the Circuit Court shall at all times be under the supervision and control of the Comptroller, and subject at all times to summary discharge and dismissal by him, and any vacancy in such receivership may be filled by the Comptroller at any time."

On being appointed liquidator of the several banks petitioner took no oath of office but was required to give bond in each appointment. He served as liquidator of some or all of the eleven banks during 1931 and 1932, receiving as compensation for his services

$5,833.33 in 1931 and $25,237.36 in 1932. The amount of his compensation was fixed by the Comptroller and represented about 2½ per cent of the funds collected by the petitioner in disposing of the assets of the liquidating banks. All such funds were received by the petitioner and remitted by him to the State Treasurer. The State Treasurer deposited five per cent of such funds in a special "Liquidator's Account" from which the petitioner drew his compensation by warrants signed by the State Treasurer and the Comptroller.. The bulk of the deposits was made in this account in 1930 and 1931. In the performance of his duties as liquidator the petitioner acted under the immediate supervision and direction of the State Comptroller who approved in advance all sales of bank properties. The petitioner devoted all of his time to these duties in both of the taxable years involved.

In his income tax returns for 1931 and 1932 the petitioner did not include in his taxable income the compensation received in those years for his services as liquidator. In explanation of the exclusion of those amounts from taxable income the 1932 return contains the following notation:

17 "ITEM 18: Article 88, Reg. 69, specifically includes compensation received in commissions as 'Receivers appointed by State Courts' as being exempt, also IT 2214 CB IV-2-2402 on Page 99 of Digest 22 rules that Receivers of State Banks in Kansas are officers of the State and compensation from that source is nontaxable under Rev. Acts of 1921 & 24, it is presumed to be applicable to 1926 & 1928 Acts in other States than Kansas..

(The above ruling given to me in communication from F. R. Clute, Internal Revenue Agent in Charge at Jacksonville, Florida; such letter being dated February 26th, 1929.)"

The petitioner's returns for 1931 and 1932 were made on the cash receipts and disbursements basis.

To be exempt from Federal taxation on constitutional grounds the income here in dispute must have been received by the petitioner from the State of Florida for services performed either as an officer or employee of the State in the exercise of an essential governmental function of the State. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; 5 A. F. T. R. 5834. We think that the petitioner was neither an officer nor an employee of the State of Florida but was an independent contractor. He held no statutory office of government but received his appointment from the State Comptroller at whose pleasure he served. His employment was not of a continuous character but was for the duration of the particular work undertaken. *Metcalf & Eddy* v. *Mitchell, supra.* A liquidator appointed to assist the Comptroller in converting the assets of defaulted banks into money for distribution to the depositors and creditors stands in approximately the same relationship to the State as an attorney appointed to assist the Attorney General in special litigation. *George Z Medalie*, 30 B. T. A. 1284; *Commissioner* v. *Murphy*, 70 Fed. (2d) 790; 14 A. F. T. R. 194; *Lucas* v. *Reed*, 281 U. S. 699; 8 A. F. T. R. 11261.

The liquidating banks were not owned by the State and were not instrumentalities of any of the State's governmental departments. The State's interest in them was to see that they functioned in compliance with its regulatory laws and, upon their failure as private institutions, to see that their assets were distributed fairly and equitably among those entitled to receive them. The tax imposed by the Federal government upon the income paid to the petitioner for assisting in this undertaking did not place such a burden upon the State of Florida as the Constitution prohibits. See *Helvering* v. *Powers*, 293 U. S. 214; 14 A. F. T. R. 709.

18

We held in *Carl Newman Davie*, 26 B. T. A. 1007, that the constitutional exemption from taxation did not apply to compensation received for legal services rendered in liquidating insolvent banks under direction of the Superintendent of Banks of the State of Georgia. Our decision in that case is controlling in the instant proceeding. See Commissioner's Ruling, dated January 17, 1936, published in Internal Revenue Bulletin No. 5, February 3, 1936.

In his petition the petitioner alleges—

> "B. That the Commissioner erred in determining that petitioner's income on which deficiency tax was assessed for the year 1932 was earned and accrued during the year 1932."

In his brief the petitioner submits the following argument in support of this contention:

> "Point 2. In making his returns for the years 1931 and 1932 the taxpayer relied upon the letter received from F. R. Clute, Internal Revenue Agent in Charge at Jacksonville, Florida, dated February 26th, 1929, reference to which is made in the taxpayer's return for the year 1932. Consequently, he made the return of the income from his investments on a cash basis, whereas he could have made his returns on an accrual basis had it not been conceded by the letter above mentioned that his income as liquidator was not subject to tax."

This contention is without merit. Admittedly the petitioner made his income tax returns upon the cash receipts and disbursements basis. It does not appear that he requested permission of the respondent to make

them upon an accrual basis. The income
19 which the petitioner received in 1932, although some of it was earned by him in a prior year. must therefore be included in his 1932 return.

Judgment will be entered for the respondent.

Enter:
Entered June 10, 1936.

(Seal)

---

20 DECISION.

United States Board of Tax Appeals,
Washington.

William H. Tunnicliffe, Petitioner,
vs. Docket No. 78714
Commissioner of Internal Revenue, Respondent.

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion entered June 10, 1936, it is

Ordered and Decided: That there are deficiencies of $34.66 and $2,689.12 for the years 1931 and 1932, respectively.

(Signed) CHARLES P. SMITH,
Member.

Enter:
Entered June 10, 1936.

(Seal)

21 PETITION OF WILLIAM H. TUNNICLIFFE FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS OF THE FIFTH CIRCUIT OF THE DECISION BY THE UNITED STATES BOARD OF TAX APPEALS (Filed June 10, 1936.)

Received Aug. 31, 1936.

Filed Aug. 31, 1936.

(Title Omitted.)

William H. Tunnicliffee, the petitioner in this cause, by H. M. Voorhis, counsel, hereby files petition for a review by the United States Circuit Court of Appeals of the Fifth Circuit of the decision by the United States Board of Tax Appeals rendered on June 10th, 1936, determining deficiencies in the petitioner's Federal income tax for the calendar years 1931 and 1932, in the respective amount of $34.66 and $2,689.12.

I.

The petitioner is an individual whose residence and address are Sanford, Florida.

22 II.

Nature of Controversy.

The controversy involves the proper determination of the petitioner's liability for Federal income tax for the calendar years 1931 and 1932.

The petitioner in the year 1930 was appointed as liquidator for eleven closed banks in central Florida by

the Comptroller of the State of Florida pursuant to Section 19 of Chapter 13576 of the General Laws of Florida (1929). He took no oath of office but gave bond in the amount of $75,000.00 and devoted all of his time to the liquidation of said banks during the years 1930, 1931 and 1932. He performed his duties under the supervision and control of the Comptroller of Florida and was subject to summary discharge and dismissal by the said Comptroller. In remitting the proceeds from collections for the various closed banks to the State Treasurer of Florida the petitioner made two checks, one in the amount of 95% of the collections, and the other in the amount of 5%. The latter check was deposited in an account called "Liquidator's Commission Account." From this account the petitioner was paid for his services by warrant drawn by the Comptroller and countersigned by the Treasurer. For the years 1931 and 1932 the petitioner was paid approximately 2½% of the amount of money in the Liquidator's Commission Account. During the year 1931 the petitioner received as compensation for his services $5,833.33, and during the year 1932, $25,-
23 237.36. The petitioner shows the receipt of the above amounts on his respective income tax returns, but excluded the amounts from his taxable income, and placed the following notation on said returns:

"Item 18: Article 88, Reg. 69 specifically includes compensation received in commissions as 'Receivers appointed by State Courts' as being exempt, also IT. 2214, CB-IV-2-2402 on Page 99 of Digest 22 Rules that Receivers of State Banks in Kansas are officers of the state, and compensation from that source is non-taxable under Rev. Acts of 1921 & 24, it is presumed to be applicable to 1926 & 1928 Acts in other states than Kansas. (The above ruling given to me in communication from F. R. Clute, Internal Revenue Agent

in Charge at Jacksonville, Florida; such letter being dated February 26th, 1929)."

The Commissioner of Internal Revenue held that the amount received by the petitioner for the years 1931 and 1932 as compensation for his services as liquidator could not be excluded from his taxable income.

III.

The said William H. Tunnicliffe being aggrieved by the finding of fact and conclusions of law contained in the said finding and opinions of the Board of Tax Appeals, and by its decision entered pursuant thereto, decided to obtain a review thereof by the United States Circuit Court of Appeals for the Fifth Circuit.

IV.

The petitioner assigns as error the following acts and omissions of the Board of Tax Appeals.

24 1. The holding that the petitioner was not an officer of the State in the exercise of an essential governmental function of the State.

2. The holding that the petitioner was not an employee of the State in the exercise of an essential Governmental function of the State.

3. The holding that the petitioner was an independent contractor.

4. The failure to notice that petitioner was appointed pursuant to a statute which defined his duties and regulated his compensation.

5. The failure to hold that the supervision of banks and banking is an essential Governmental function of the State.

6. The holding that the Federal Government tax upon the income paid to the petitioner did not place such a burden upon the State of Florida as the Constitution prohibited.

7. The finding of deficiencies for the years 1931 and 1932 in lieu of the determination that there is no income tax due from the petitioner for either of the years in controversy.

H. M. VOORHIS,
Counsel for Petitioner,
Florida Bank Building, Orlando, Florida.

25 State of Florida,
County of Orange.

H. M. Voorhis being first duly sworn says that he is Counsel of record in the above named cause; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements contained therein and the statements are true to the best of his knowledge, information and belief.

H. M. VOORHIS.

Subscribed and sworn to before me this 22nd day of August, 1936.

MARY B. HUFFAKER,
Notary Public State of Florida at Large.
My commission expires 3-21-38.

(Notarial Seal)

26 PRAECIPE FOR RECORD.

Received Oct. 2, 1936.

Filed Oct. 2, 1936.

(Title Omitted.)

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals of the Fifth Circuit, with reference to petition for review heretofore filed by the petitioner in the above cause, a transcript of the record in the above cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of record the following documents or certified copies, thereof to-wit:

(1) The docket entries of all proceedings before the Board of Tax Appeals.

(2) Pleadings before the Board of Tax Appeals, as follows:

(a) Petition for Redetermination;

27 (b) Answer of Respondent;

(c) Amendment to the petition filed February 24th, 1936.

(3) The findings of fact and opinion of the Board of Tax Appeals.

(4) The decision of the Board.

(5) The petition for review, filed by the petitioner in the above cause.

(6) This praecipe.

H. M. VOORHIS,
Counsel for Petitioner,
Florida Bank Building, Orlando, Florida.

CERTIFICATE.

United States Board of Tax Appeals,
Washington.

William H. Tunnicliffe, Petitioner,
vs. Docket No. 78714
Commissioner of Internal Revenue, Respondent..

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 27, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 12 day of Oct., 1936.

B. D. GAMBLE,
Clerk, United States Board of
Tax Appeals.

(Seal)

That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

Argument and submission

Extract from the Minutes of February 1st, 1937

No. 8259

WILLIAM H. TUNNICLIFFE

v.

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, upon the joint request of counsel, and, after argument by H. M. Voorhis, Esq., for petitioner, and Howard P. Locke, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

Petition for review of decision of United States Board of Tax Appeals (District of Florida)

March 9, 1937

Before FOSTER, SIBLEY, and HUTCHESON, Circuit Judges

SIBLEY, Circuit Judge: This petition for review involves similar facts and the same questions dealt with in the opinion this day filed in No. 8212, John H. Therrell vs. Commissioner of Internal Revenue. For the reasons stated in that opinion the judgment is reversed with direction to eliminate the contested tax.

Reversed.

HUTCHESON, Circuit Judge, dissenting.

Judgment

Extract from the Minutes of March 9th, 1937

No. 8259

WILLIAM H. TUNNICLIFFE

v.

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of William H. Tunnicliffe for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel:

On consideration whereof, It is now here ordered, adjudged, and decreed by this Court, that the judgment of the said United States Board of Tax Appeals in this cause be, and the same is hereby, reversed, with direction to eliminate the contested tax.

HUTCHESON, Circuit Judge, dissenting.

Clerk's certificate

United States of America

United States Circuit Court of Appeals, Fifth Circuit

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 28 to 31 next preceding this certificate contain full, true, and complete copies of all the pleadings, record entries, and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said court, numbered 8259, wherein William H. Tunnicliffe is petitioner, and Commissioner of Internal Revenue is respondent, as full, true, and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 27 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 24th day of May A. D. 1937.

[SEAL]

OAKLEY F. DODD,
Clerk of the United States Circuit Court of Appeals, Fifth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1937

Order allowing certiorari

Filed October 11, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice BLACK took no part in the consideration and decision of this application.

U. S. GOVERNMENT PRINTING OFFICE, 1937

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM H. TUNNICLIFFE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit, entered in the above entitled cause on March 9, 1937, reversing the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 15–21) is a memorandum opinion which is not reported. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 29) is reported in 88 F. (2d) 873.

149305—37

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 9, 1937. (R. 29.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts received by the respondent as compensation for services as liquidator of certain State banks, paid entirely out of funds of the banks, are immune from Federal taxation.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations will be found in the Appendix in the petition for a writ of certiorari filed simultaneously herewith in the case of *Helvering* v. *Therrell,* No. —.

STATEMENT

The facts in this case as stated in the opinion of the Board of Tax Appeals (R. 15–21) may be summarized as follows: The respondent, in 1930, was appointed as liquidator of eleven banks in the State of Florida, these appointments being made by the State Comptroller pursuant to Section 19 of Chapter 13576 of the General Laws of Florida (1929), Vol. 1. (R. 16.)

The respondent took no oath of office but gave a bond under each appointment. He served as liquidator of some or all of the eleven banks during 1931 and 1932, and received as compensation for his

services the amount of $5,833.33 in 1931, and $25,237.36 in 1932. The amount of the compensation which he received was fixed by the Comptroller of the State of Florida at a certain percentage of the funds collected by him in liquidating the various banks, and was paid entirely out of funds of the institutions liquidated. (R. 17–18.) The respondent did not include in his income tax returns for either 1931 or 1932 the compensation received by him for services as liquidator. He stated that this action was taken by him on advice from the Internal Revenue Agent in charge at Jacksonville, Florida. (R. 18.)

The Commissioner of Internal Revenue determined that respondent was not exempt from taxation and appeal was taken to the United States Board of Tax Appeals. The Board of Tax Appeals sustained the Commissioner and the respondent sought review of that action by the Circuit Court of Appeals for the Fifth Circuit. That court reversed the decision of the Board, one judge dissenting.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the respondent as liquidator was not subject to Federal income taxation.

2. In failing to hold that the respondent was neither an officer, an employee, nor an agent of the

State engaged in an essential governmental function.

3. In failing to hold that taxation of the compensation received by the respondent out of funds of the insolvent banks imposes no prohibited burden upon the State.

REASONS FOR GRANTING THE WRIT

The instant case presents the identical question involved in *Helvering* v. *Therrell,* and was decided by the court below contemporaneously with and upon the authority of its decision in that case. The Government has this day filed a petition for a writ of certiorari in that case, and respectfully refers the Court to the reasons stated in that petition as reasons why the present petition should be granted.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

JUNE, 1937.

U. S. GOVERNMENT PRINTING OFFICE: 1937

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CITATION

Case:

Helvering v. *John H. Therrell*, No. 128, present term 4

29252—37

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 129

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM H. TUNNICLIFFE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 15–21) is not reported. The opinion of the United States Circuit Court of Appeals for the Fifth Circuit (R. 29) is reported in 88 F. (2d) 873.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 9, 1937 (R. 29). Petition for certiorari was filed June 9, 1937, and was granted

October 11, 1937 (R. 31). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts received by the respondent as compensation for services rendered as liquidator of certain Florida State banks and paid entirely out of funds of the banks are immune from Federal taxation on the ground that such a tax would be an unconstitutional burden upon the State.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations will be found in the Appendix of the petitioner's brief in the case of *Guy T. Helvering, Commissioner of Internal Revenue* v. *John H. Therrell, also known as J. H. Therrell,* No. 128, filed with the Court simultaneously herewith.

STATEMENT

The material facts as they appear in the memorandum opinion of the Board of Tax Appeals (R. 15–21) may be summarized as follows:

The respondent, in 1930, was appointed liquidator of eleven banks in the State of Florida, by the Comptroller of the State of Florida, pursuant to the provisions of Section 19, General Laws of Florida (1929), Vol. I, c. 13576, amending Section 4162, Revised General Statutes (R. 16).

The respondent, on being appointed liquidator, took no oath of office, but gave a bond under each

appointment (R. 17). He served as liquidator of some or all of the eleven banks during the years 1931 and 1932 and received as compensation for his services as liquidator $5,833.33 in 1931, and $25,-237.36 in 1932 (R. 17–18). This compensation was fixed by the Comptroller of the State of Florida at a certain percentage of the funds collected by him in liquidating the various banks pursuant to the General Laws of Florida (1929), Vol. I, c. 13576, Sec. 19, amending Section 4162, Revised General Statutes, and represented about two and one-half percent of the funds collected by the respondent in disposing of the assets of the liquidating banks, and was paid out of funds of the institutions liquidated (R. 18).

In the performance of his duties as liquidator the respondent acted under the immediate supervision and direction of the State Comptroller (R. 18) and devoted all of his time to his duties as liquidator in both of the taxable years involved (R. 18).

The respondent did not include in his income tax returns for 1931 or 1932 the compensation received by him for services as liquidator, upon the advice of the Internal Revenue Agent In Charge at Jacksonville, Florida (R. 18). The Commissioner of Internal Revenue included the sums received by the respondent as liquidator in his taxable income for Federal income tax purposes. The Board of Tax Appeals, holding that the petitioner was

neither an officer nor employee of the State of Florida, but an independent contractor (R. 19) and further that a Federal income tax imposed upon the income realized by the respondent as liquidator of state banks imposes no burden on the State of Florida prohibited under the Constitution (R. 19), determined deficiencies in respondent's income for the years 1931 and 1932 of $34.66 and $2,689.12, respectively (R. 21). The Circuit Court of Appeals, one judge dissenting, reversed the decision of the Board of Tax Appeals.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the respondent as liquidator was not subject to Federal income taxation.

2. In failing to hold that the respondent was neither an officer, an employee, nor an agent of the State engaged in an essential governmental function.

3. In failing to hold that taxation of the compensation received by the respondent out of funds of the insolvent banks imposes no prohibited burden upon the State.

ARGUMENT

This case presents, on indistinguishable facts, the identical question presented in *Guy T. Helvering, Commissioner of Internal Revenue* v. *John H. Therrell, also known as J. H. Therrell,* pending on

writ of certiorari, No. 128, present term. In the interest of brevity, the petitioner adopts and incorporates herein by reference the argument made on behalf of the petitioner in No. 128.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

STANLEY REED,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
BERRYMAN GREEN,
Special Assistants to the Attorney General.
WARNER W. GARDNER,
Special Attorney.

NOVEMBER 1937.

U. S. GOVERNMENT PRINTING OFFICE: 1937

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 129.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

WILLIAM H. TUNNICLIFFE, RESPONDENT.

RESPONDENT'S BRIEF.

The petition for certiorari apparently concedes that the respondent was an officer or employee of the state, engaged in an essential governmental function. This being true, the only point relied upon by the petitioner as a predicate for the writ sought is *the source of compensation paid respondent,* and this point, we submit, was removed from the realm of any serious controversy by this court in the case of *Brush* v. *Commissioner of Internal Revenue,* decided May 15th, 1937, and reported in 300 U. S. 352, wherein the salary of the petitioner received from the Bureau of Water Supply of the City of New York, a municipally owned and operated water plant, was held immune.

Respectfully submitted,

HARRY M. VOORHIS,
Attorney for Respondent.

July 12th, 1937.

FILE COPY

Office - Supreme Court, U. S.
FILED
DEC 8 1937
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 129.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

WILLIAM H. TUNNICLIFFE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF OF RESPONDENT.

H. M. VOORHIS,
Orlando, Florida,
Attorney for Respondent.

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Supreme Court of the United States

OCTOBER TERM, 1937.

No. 129.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

WILLIAM H. TUNNICLIFFE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF OF RESPONDENT.

QUESTION PRESENTED.

Is the Compensation Received by the Respondent As Liquidator of Certain Florida State Banks, and Paid from Funds in the State Treasury Realized from Liquidating the Assets of Said Banks, Subject to Federal Taxation?

STATUTES AND REGULATIONS INVOLVED.

The relevant statutes and regulations will be found in the appendix of the respondent's brief in the case of *Guy T. Helvering, Commissioner of Internal Revenue,* v. *John H. Therrell, Also Known As J. H. Therrell, No.* 128, filed with the court simultaneously herewith.

STATEMENT OF THE CASE.

We believe that the statement as set forth in the brief for the petitioner is substantially correct.

SUMMARY OF ARGUMENT.

I. Respondent was an officer or employee of the State of Florida.

II. The respondent was engaged in an essential governmental function.

III. The source of the compensation of respondent is immaterial.

IV. Article 643 of Treasury Regulations 74 and Article 643 of Treasury Regulations 77 show administrative recognition of the respondent's contention.

ARGUMENT.

This case presents substantially the same question as presented in *Guy T. Helvering, Commissioner of Internal Revenue,* v. *John H. Therrell, Also Known As J. H. Therrell,* pending on writ of certiorari, No. 128, present term. Therefore the respondent adopts and incorporates

herein by reference the argument made on behalf of the respondent in No. 128.

CONCLUSION.

The decision of the United States Circuit Court of Appeals should be affirmed.

Respectfully submitted,

H. M. VOORHIS,
Attorney for Respondent.

December, 1937.

CLERK'S COPY.

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U.S.B.C.

Pat

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1937

No. 287

EDWARD McLOUGHLIN, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 5, 1937.

CERTIORARI GRANTED OCTOBER 11, 1937.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 287

EDWARD McLOUGHLIN, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., OCTOBER 20, 1937.

—1766

[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 80,484

EDWARD McLOUGHLIN, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

Appearances:

For Petitioner: Bernhard Knollenberg, Harry J. Rudick, Joseph W. Wyatt.

For Commissioner: James H. Yeatman, Esq.

1935.

June 13. Petition received and filed. Taxpayer notified. (Fee paid.)

" 13. Copy of petition served on General Counsel.

Aug. 10. Answer filed by General Counsel.

" 15. Copy of answer served on taxpayer.

Sept. 14. Hearing set October 21, 1935.

Oct. 17. Motion to adjourn hearing to October 28, 1935, filed by taxpayer. October 18, 1935, granted.

Oct. 28. Hearing had before Mr. C. R. Arundell, Division 7. Submitted on the merits. Stipulation of facts and appearance of Mr. Wyatt, filed. Petitioner's brief due November 30, 1935. Respondent's December 14, 1935. Petitioner's reply due January 2, 1936.

[fol. 2]

Nov. 2. Transcript of hearing October 28, 1935, filed.

" 13. Brief filed by taxpayer. November 13, 1935, copy served.

Dec. 31. Motion for leave to file brief. Brief lodged, filed by General Counsel. January 3, 1936, granted.

1936.

Jan. 3. Order that time for respondent's brief be extended to January 3, 1936, and that time for Petitioner's brief be extended to January 23, 1936, entered.

" 30. Motion for leave to file reply brief *reply brief* lodged, filed by taxpayer.

" 31. Motion for leave to file reply brief granted.

DOCKET ENTRIES—Continued

1936.

Feb. 4. Copy of motion and reply brief served.
Aug. 19. Findings of fact and opinion rendered, Mr. C. R. Arundell, Division 7. Decision will be entered for respondent.
" 21. Decision entered, C. R. Arundell, Division 7.
Sept. 17. Motion for rehearing or reconsideration filed by taxpayer. September 24, 1936, denied.
Oct. 13. Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
" 13. Proof of service filed by taxpayer.
" 13. Præcipe filed.
" 13. Proof of service of præcipe filed.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed June 13, 1935

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:A-1, LWB-90D), dated March 15, 1935, and as a basis for his proceeding alleges as follows:

1. The Petitioner is an individual residing at 361 First Street, Brooklyn, New York.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was dated and presumably was mailed to the Petitioner on March 15, 1935.

3. The taxes in controversy are income taxes for the year 1932 in the sum of $224.09.

4. The determination of tax set forth in said notice of deficiency is based upon the following error:

[fol. 4] Inclusion in the Petitioner's gross income for the year 1932 of the sum of $5,125 received by him as an employee of the State of New York, whereas Petitioner maintains that he is exempt from federal income tax on this compensation because it is compensation received by him for his services as an employee of the State.

5. The facts upon which the Petitioner relies as a basis of this proceeding are as follows:

Petitioner is an employee of the Insurance Department of the State of New York. He devotes, and throughout the year 1932 devoted, his entire time to the work of this Department. The entire amount in question was received by him as compensation for this work.

Wherefore, the Petitioner prays that this Board may hear the proceeding and redetermine the deficiency alleged by the Respondent herein.

(S.) Bernhard Knollenberg, Harry J. Rudick, Counsel for Petitioner, 25 Broadway, New York, New York.

Duly sworn to by Edward McLoughlin. Jurat omitted in printing.

[fol. 5] EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

March 15, 1935.

Mr. Edward McLoughlin, 361 First Street, Brooklyn, New York.

SIR:

You are advised that the determination of your income tax liability for the year 1932 discloses a deficiency of $224.09 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. [fol. 6] Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period termi-

nates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by
(Signed) Chas. T. Russell, Deputy Commissioner.

Enclosures: Statement, Form 870.

[fol. 7] Statement

IT:AR:A-1.
LWB-90D.

In re Mr. Edward McLoughlin, 361 First Street, Brooklyn, New York

Income Tax Liability

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1932	$224.09	none	$224.09

An examination of your income tax return for 1932 reveals that you received compensation from the State of New York Insurance Department amounting to $5,125.00, which was not included as taxable income.

The Bureau holds that where liquidators are engaged to render services in connection with the liquidation of a bank by the Banking Department of a state and their compensation is paid from funds or assets of the bank being liquidated, such compensation must be included in gross income for Federal income tax purposes. (See G. C. M. 13488, published in Internal Revenue Bulletin XIII-35, page 9.)

The revised computation of your income tax liability is shown below:

Net income shown on return	$676.18
Add:	
Compensation	5,125.00
Net income revised	$5,801.18
[fol. 8] Less:	
Personal exemption	1,000.00
Balance subject to normal tax	$4,801.18
Normal tax at 4% on $4,000.00	$160.00
Normal tax at 8% on $801.18	64.09
Income tax liability	$224.09
Income tax assessed	none.
Deficiency	$224.09

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1932, the Income Tax Unit will be unable to afford you an opportunity to discuss your case before mailing formal notice of its determination as provided by section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934. It is, therefore, necessary at this time to issue this formal notice of deficiency.

[fol. 9] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER—Filed August 10, 1935

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, for answer to the petition filed by the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies the errors alleged in paragraph 4 of the petition.

5. Denies the material allegations of fact set forth in paragraph 5 of petition.

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore [fol. 10] admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's petition be denied.

(Signed) Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue. Of Counsel: James H. Yeatman, Special Attorney, Bureau of Internal Revenue.

JHY/nc 8/9/35.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

STIPULATION OF FACTS—Filed October 28, 1935

The parties to the above-styled proceeding, by their respective counsel of record, hereby stipulate and agree [fol. 11] that the following facts are true:

1. The petitioner is an individual and resides at 361 First Street, Brooklyn, New York. He filed his income tax return for 1932 with the Collector of Internal Revenue for the First District of New York, whose office is located at Brooklyn, New York.

2. The taxes in controversy are income taxes for the calendar year 1932 and the amount of the deficiency determined by the respondent for such year is $224.09. On his return for the calendar year 1932 the petitioner reported that he had received a salary of $5,125.00 during said year from the New York State Insurance Department but claimed the amount as a deduction under Item 18 of the return. In the deficiency letter on which this proceeding is based Respondent held that the compensation of $5,125.00 is subject to Federal income tax. The only question for determination by the Board in this proceeding is whether said income is taxable.

3. The petitioner is an attorney at law. Prior to 1929 he was associated with the law firm of Richards, Smyth and Conway, 32 Court Street, Brooklyn, New York, and was actively engaged in the practice of law with such firm. In 1929 the petitioner was appointed Secretary to the then Superintendent of Insurance of the State of New York and he occupied this position for approximately six months. In 1930 he was requested by the Superintendent of In- [fol. 12] surance to act as counsel in the Liquidation Bureau, a branch of the Insurance Department. He performed these duties from the beginning of 1930 to and until August 2, 1933. During the year 1932 the Liquidation Bureau maintained three offices in New York. The main office was in the State Building at 80 Center Street, where petitioner was employed during 1932, and there were two branch offices, one at 2 Lafayette Street, and the other at 111 John Street, New York, New York. The petitioner

gave full time required of employees in the Liquidation Bureau, and his hours were from 9 A. M. to 5 P. M., the same as other attaches of that Bureau who were not engaged in legal work.

4. After severing connections with the law firm with which he was connected in 1929 petitioner received no further salary from said firm. He maintained office space in the office of said firm and did a certain amount of personal legal work such as the preparation of wills, et cetera, all of which was accomplished out of his regular hours. In doing this personal work petitioner would get the assistance of one of the members of the law firm to handle or cooperate in the same, and the amount of any fees resulting therefrom would be divided according to mutual agreement with such individual. Petitioner's personal legal fees in 1932 amounted to $1,410.00 and his office expenses were $570.00. The greater part of such sum represented fees from matters commenced in 1929, prior to his association with the Insurance Department. None of the personal legal work which he obtained after becoming associated with the insurance Department was the result, [fol. 13] either directly or indirectly, of such association.

5. The liquidation Bureau was created in 1909 and is now known as the Bureau of Liquidations, Conservations and Rehabilitations. This change in designation occurred sometime in 1933 and was made to make the name of the Bureau conform to the description of the title of Article 11, Chapter 191, of the Insurance Laws of the State of New York, which went into effect on March 15, 1932. For the sake of brevity the Liquidation Bureau (known as Bureau of Liquidations, Conservations and Rehabilitations after 1933) will be hereinafter referred to as the Bureau. The Bureau was in the year 1932 and now is in charge of a Special Deputy Superintendent of Insurance. Said Deputy Superintendent is a Civil Service employee of the State of New York, and his salary is paid directly by the State. The Bureau also had in 1932 three assistant Special Deputy Superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants. At the beginning of 1932 the Bureau had approximately 100 employees and at the end of 1932 the number had been increased to approximately 400. None of said persons, with the exception of the Special Deputy Superin-

tendent in charge, were Civil Service employees. The number of employees varies according to the number of insurance companies under the Bureau's jurisdiction.

6. The general functions and duties of the Bureau are as follows: Under the Insurance Laws of the State of New [fol. 14] York the Superintendent of Insurance of that State may, on certain grounds, apply to the judicial authorities of the State for an order directing him to take over the assets of insurers doing business or in process of organization for the purpose of doing business in such State, for the purpose of liquidating, rehabilitating or conserving the business of such insurers. Upon an order directing rehabilitation, liquidation or conservation being granted, all of the work necessary to accomplish any of these results is performed by the Bureau. When an order is obtained directing the liquidation of an insurance company its charter is dissolved and no new business is transacted. The work of liquidation consists of adjudicating the claims of the creditors of the company, selling the real estate and the other assets and attempting to collect premiums due. After all of the assets of a company have been realized upon, dividends are distributed pro rata to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company. Of the assets available for distribution of insolvent companies the proceeds of liquidation first go to the payment of claims of creditors who have claims under policies or bonds issued by the insurer prior to the time that the Superintendent took over the affairs of the company for the purpose of liquidation. Any money left over after the payment to creditors is first used for the purpose of refunding the paid-in premiums and if any balance is left it is distributed to the stockholders of the company. It is only in exceptional cases that stockholders have recovered anything. There is attached hereto and made a part hereof as Exhibits A and [fol. 15] B, statements showing the companies being liquidated by the Bureau and certain data concerning same as of January 1, 1932, and December 31, 1932. When an order is obtained directing the rehabilitation of an insurance company the Bureau actively operates it (but conducts no new business) and takes steps to remove the causes and conditions which made such proceeding necessary in an effort to bring about its rehabilitation and place the company in

a sound financial condition. If the Bureau succeeds in rehabilitating the insurer, the assets are turned back to it and it resumes operations under its own direction. If and when it is determined that further efforts to rehabilitate a company will be futile the Superintendent of Insurance may apply for an order of liquidation. No rehabilitation work was done by the petitioner or the Bureau in 1932. Although the Superintendent of Insurance was authorized to apply for rehabilitation orders, no such order was applied for until the year 1933. When an order is obtained directing the Superintendent to take over the assets of a foreign insurer for the purpose of conservation, the Bureau proceeds to collect the assets and conserve them for the benefit of policy holders and others to whom the company is obligated. In a conservation proceeding the Bureau acts much in the same manner as the ancillary receiver of a foreign corporation. The major portion of the work of the Bureau consists of liquidating insolvent insurers doing business in the State of New York. Upon taking charge of a company for liquidation purposes certain of the staff of the company such as underwriters and the so-called "production staff" would be dismissed. The key employees would [fol. 16] be retained, and the remainder dismissed as soon as practicable. It was the policy of the Bureau to centralize the liquidation work as much as possible in one office. The procedure would necessarily vary according to the size of the companies placed in liquidation, etc. In the case of a very large company its affairs could not be transferred to another office for a long period of time.

7. In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record. He devoted over 90% of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office. The balance of his time was devoted to legal problems of the Bureau as a whole, such as the drafting of a new Article XI of the Insurance Law.

8. In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. The expenses of the Bureau, including all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account," as simultaneously with the drawing of

checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet [fol. 17] petitioner's compensation and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having charge of all the assets of such company) was in a position to draw checks on the account.

9. Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted to the affairs of one particular company, would be charged against such company. Petitioner's time devoted to the general legal problems of the Department, would be prorated among the various companies under a formula designed to charge general administration expenses of the Department to the companies in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies.

10. Petitioner's compensation during 1932 was paid bimonthly but was computed on an annual basis. Petitioner was paid by check, a form of the check used being annexed hereto as Exhibit "C." Petitioner did not receive any additional compensation from the Insurance Department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the Superintendent and the compensation did not vary [fol. 18] in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the Superintendent of Insurance.

11. In the budget of the Superintendent of Insurance there appeared an item called the Reserve Fund, for the use of the Superintendent in liquidating insurance compa-

nies whose assets were not sufficient to pay the costs of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932 and 1933, the amount of the Reserve Fund was $5,000.00. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund.

Bernhard Knollenberg, Counsel for Petitioner. Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, Counsel for Respondent.

(Here follows 4 photos, side folios 19 to 22)

TABLE E — PART II

Liquidation Proceedings Pending January 1, 1932 — Transferred to Closed and Inactive Proceedings During the Year 1932

Name of Company	Principal office	Proceedings commenced	Realized on assets	Total liabilities		Disbursements for liquidation expenses, taxes and for conservation of assets	Distributed to: Preferred and secured creditors (paid in full)	Distributed to: Other creditors	Distributed to: Members or stockholders	Per Cent of Distribution: Other creditors	Per Cent of Distribution: Members or stockholders	Assets Undistributed: Cash	Assets Undistributed: Other assets (book value)
	B	C	D	E		F	G	H	I	J	K	L	M
General Corporations													
1. Allied Automobile Owners Association, Inc. ■	Brooklyn	April 8, 1930	$1,094 80	$3,422 43	1.	$780 65		$342 84		7		$10 16	
2. Interstate Reciprocation Corporation ■	Brooklyn	April 30, 1930	347 43		2.	332 99						14 43	
Life, Health and Casualty Insurance Corporations													
3. Brooklyn Taxpayers Association, Inc. ◆	New York	July 10, 1929	25,014 15	13,543 62	3.	4,949 53	$1,295 26					18,769 26	
4. Columbia Life Assurance Society ■ **	New York	June 27, 1911	4,749 76	1,745 60	4.	2,404 76	1,745 60					599 37	
5. Interborough Taxpayers Protective Ass'n, Inc. **	New York	July 20, 1929	13,889 16	5,479 77	5.	3,986 97	281 33	5,195 44		100 with int.		6,422 42	
Fire Insurance Corporations													
6. Consolidated Assurance Company, Ltd., U. S. Branch **	New York	Oct. 14, 1926	239,945 73	80,205 11	6.	11,955 24	47,485 28	2,719 82		100 with int.		42,785 38	*$100,000 00
7. Monroe Fire Insurance Co. of Monroe, U. S. Branch ■	New York	Aug. 8, 1925	767,859 39	661,397 55	7.	97,639 50	29,670 30	633,327 25		100 with int.		*8,522 25	*1,098,500 00
8. Nordia Lloyd Insurance Company, Ltd., U. S. Branch ■ **	New York	May 3, 1922	3,360,751 64	154,460 68	8.	289,152 79	115,268 90	809,555 04		100 with int.		2,229 55	
9. Northern Insurance Company, Monroe, U. S. Branch ■	New York	June 6, 1926	489,289 38	134,102 00	9.	*95,546 37	65,020 54	20,251 14		100 with int.		*33,348 60	*200,000 00
10. Queens, Suffolk Mutual Fire Ins. Corp. of L. I. ■	Prospect	Jan. 8, 1925	4,346 00	381 53	10.	230 15	31 53	350 00	$1,371 22	100	18 83	2,343 19	
11. Russian Reinsurance Company, U. S. Branch ■ **	New York	Aug. 8, 1925	980,688 68	251,440 25	11.	84,087 34	45,242 80	176,077 44		100 with int.		2,454 06	*191,825 09
12. Second Russian Insurance Company, U. S. Branch ■ **	New York	May 22, 1925	1,364,572 64	1,082,501 10	12.	*165,902 13	55,898 51	1,026,902 50		100 with int.		1,223 56	
Marine Insurance Corporations													
13. Jewelers Safety Fund Society ■	New York	Oct. 13, 1927	515,912 13	283,750 29	13.	94,467 18		283,750 29	159,775 62	100 with int.		7,919 04	*14,071 78
14. Liberty Marine Insurance Company **	New York	Feb. 14, 1931	922,634 29	973,981 73	14.	120,806 22	151,929 10	627,491 18		75 —	100	22,268 81	
15. North Atlantic Insurance Company **	New York	Feb. 14, 1931	969,457 66	967,991 05	15.	137,821 04	163,177 33	653,849 04		75		14,439 67	
Title and Credit Guaranty Corporations													
16. North American Title Guaranty Company **	New York	Aug. 26, 1930	288,023 00	103,315 73	16.	53,518 00	73,202 51	7,109 77		25		70,433 16	15,500 00
17. Onondaga Guaranty and Title Company ■	Syracuse	Sept. 9, 1932	225,506 00	302 96	17.	472 21	302 96		221,839 61		147 83	3,000 00	
Mutual Employers' Liability and Workmen's Compensation Corporations													
18. Empire State Mutual Insurance Company ◆ **	New York	Oct. 9, 1929	458,634 49	15,434 50	18.	27,581 86	42,774 60					26,080 94	11,057 93
Life or Casualty Insurance Corporations upon the Cooperative or Assessment Plan													
19. Protective Life Assurance Society ■	Buffalo	Feb. 7, 1917	27,486 42	23,511 82	19.	3,222 19		23,511 82		100 with int.		721 41	
20. Scandia Life Insurance Society ■	New York	Nov. 17, 1930	84,633 40	18,054 92	20.	4,619 29		18,054 92	60,000 00	100 with int.		1,393 19	

■ — Proceedings completed.
◆ — Final distribution withheld pending confirmation of reports filed with Supreme Court of New York County.
4 ** — Further distribution, if any, dependent upon amount received from auction sale of Ward's Island property.
5 ** — Final distribution withheld pending determination of liability for Federal and State taxes.
6 ** — Final distribution withheld pending determination of liability on claim now pending before Supreme Court of New York County. — $116,000.30 transmitted to British Liquidator.
8 M* — Held by State of Ohio.
9 L.* (M*) — Available for distribution, less reserves for two claims not adjudicated and further expenses of liquidation
9 ** — Payments of $2,142,930.36 made to Norwegian Liquidator.
10 F* — In addition $92,383.18 paid for legal services out of surplus assets pursuant to order of Supreme Court.
10 L.* (M*) — Available for distribution, less further expenses of liquidation.

11 **— Surplus assets of $332,000.00 in securities and $353,106.91 in cash were turned over to Company.
11 M* — Held by State of Ohio.
12 F* — In addition $51,723.72 paid for legal services out of surplus assets pursuant to order of Supreme Court.
12 ** — $100,000.00 in securities constituting deposit with State of Ohio transmitted directly to assignee by the State of Ohio Insurance Department. $14,855.68 paid to Bank of Manhattan Company, as assignee.
13 M* — Further distribution withheld pending possible additional recoveries from members included in this amount.
14 ** — Further distribution withheld pending determination liability for Federal and State taxes.
14 M* — Other assets consist of claims against Receiver of Hanover & Company and of salvage claims.
15 M* — Final distribution withheld pending determination of two claims disallowed by Liquidator and appealed by claimants.
16 ** — $304,217.00 turned over to Utica Mutual Insurance Company pursuant to reinsurance agreement dated October 18, 1930.
20 K* — Distribution to members on old account at rate of 10.26% and on new account at rate of 42.3%

EXHIBIT "A" TO STIPULATION

19

EXHIBIT A (CONT'D.)

TABLE E — PART II — (Continued)

LIQUIDATION PROCEEDINGS PENDING JANUARY 1, 1932 — TRANSFERRED TO CLOSED AND INACTIVE PROCEEDINGS DURING THE YEAR 1932 — (*Concl'd*)

Name of Company	Principal office	Proceedings commenced	Realized on assets	Total liabilities	Disbursements for liquidation expenses, taxes and for conservation of assets	Distributed to: Preferred and secured creditors (paid in full)	Distributed to: Other creditors	Distributed to: Members or stockholders	Per Cent or Distribution: Other creditors	Per Cent or Distribution: Members or stockholders	Assets Undistributed: Cash	Assets Undistributed: Other assets (book value)
	B	C	D	E	F	G	H	I	J	K	L	M
Fraternal Benefit Business												
21. Sub Pelagian Sign [illegible]	[illegible]	Feb. 26, 1921	$927,989 16	$999,422 30	21. $22,234 72	$3,615 20	$220,200 21		80.85		$1,310 97	
22. United Sickly Grand Lodge of the Order Ralph Abaloo **	New York	Dec. 21, 1927	43,289 20	50,327 99	22. 6,300 20	6,336 61	38,023 66				177 92	
Cooperative Fire Insurance Corporations												
23. Fidelity Cooperative Fire Insurance Company [illegible]	Alfred	April 17, 1922	155,288 15	130,346 93	23. 24,927 19		130,346 93		100 with int.		114 42	
Lloyds and Inter-Insurers												
24. Liberty Underwriters of New York **	New York	Feb. 2, 1929	27,731 84	27,474 33	24. 11,577 02	2,399 17	13,857 39	A	50.		1,306 97	$97,420 84
Mutual Automobile Fire Insurance Corporations												
25. Automobile Motors Prefabricated Mutual Fire Ins. Company **	New York	Mar. 28, 1929	1,250 95	2,000 97	25. 600 21	694 19					300 85	
26. Motor Car Mutual Fire Insurance Company **	New York	Mar. 7, 1922	40,735 31	37,326 98	26. 34,986 51	1,699 41	13,779 79		50.		1,419 80	
Mutual Automobile Casualty Insurance Corporations												
27. City Service Mutual Casualty Corp. ◆	New York	Dec. 15, 1925	259,563 97	454,522 39	27. 69,302 52	7,139 02	134,301 07		30.		49,907 48	
28. Fifth Avenue Mutual Indemnity Company ◆	New York	April 19, 1926	310,446 68	391,562 23	28. 53,517 72	3,702 04	115,309 19		40.		35,926 89	
29. Lincoln Auto Mutual Casualty Corp. **	New York	Nov. 20, 1927	176,622 68	235,744 68	29. 61,657 27	694 51	110,588 23		34.		4,102 67	
30. Motor Car Mutual Casualty Company **	New York	Mar. 7, 1922	299,329 65	178,516 65	30. 84,878 65	8,730 45	173,056 60	$97,000 00	100 with int.	32.49	1,944 33	
31. Mutual Automobile Liability Insurance Company ** ◆	New York	Oct. 25, 1922	35,755 73	17,304 48	31. 14,006 52	699 57	10,813 11	4,496 36	100 with int.	100 with int.	297 84	
32. National Automobile Mutual Casualty Company ◆	New York	June 23, 1923	306,194 19	177,853 34	32. 102,483 33	32,917	144,905 67		100.		104,858 42	1.
33. New York Mutual Casualty Insurance Corp. ◆	New York	Feb. 23, 1926	79,728 88	260,335 39	33. 23,637 19	1,570	28,886 95		50.		18,919 68	
34. Standard Automobile Mutual Casualty Company ◆	New York	April 5, 1923	171,648 65	125,399 10	34. 77,666 39	11,992 35	62,343 13		60.		13,545 13	102.75
35. Twentieth Century Mutual Auto. Cas. Insurance Co. ◆	New York	Nov. 21, 1925	302,795 72	257,462 88	35. 84,686 41	699 20	102,641 79		40.		69,686 32	
36. U. S. Mutual Automobile Casualty Company **	New York	Sept. 26, 1921	139,738 37	30,000 82	36. 41,876 55	4,226 62	16,274 98	30,000 00	100 with int.	75.65	8,361 88	
37. World Mutual Casualty Company ◆	New York	June 23, 1924	227,314 47	139,304 84	37. 113,713 84	31,994 36					82,907 37	
Fire and Marine Insurance Corporations												
38. Spike-American Fire & Marine Insurance Company [illegible]	New York	Jan. 26, 1931	10,391 83	5,334 67	38. 3,772 36		5,334 67	729 42	100 with int.	3.	55 44	
Miscellaneous												
39. Commeyenne's Mutual Aid Society [illegible]	New York	Mar. 31, 1931	66,662 33	888 41	39. 3,173 89		888 41	60,337 75	100 with int.	88.89	987 64	

** — Further distribution contingent upon amount received from sale of equality plots, only remaining assets.
24 ◆ — Dividends paid on disability claims 4.286%, other claims 24.57%.
26 ** — Additional distribution contingent upon further collections on subscription notes of underwriters.
29 ** — Negotiations pending with officers of this corporation to pay all claims in full.
30 ** — Additional distribution contingent upon further collection of assessment.
32 ** — Further distribution withheld pending determination of liability for State taxes.
34 ** — Final distribution withheld pending confirmation of reports of Referee.
36 ** — Final distribution of assessment deposit to members withheld pending sale of judgments.

TABLE E — PART III

LIQUIDATION PROCEEDINGS PENDING ON DECEMBER 31, 1932

Name of Company (A)	Principal office (B)	Statement of Condition as Last Reported (Prior to Liquidation) — Assets: Admitted (C)	Assets: Non-admitted (D)	Liabilities (except capital) (E)	Proceedings commenced (F)	Disposition of Claims Filed: Allowed (G)	Disallowed (H)	Suspended (I)	Disbursements for liquidation expenses, taxes and for conservation of assets (J)	Payments Made: Preferred and secured creditors (paid in full) (K)	Other creditors (L)	Per cent of claims paid to other creditors (M)	Assets Undistributed: Cash (N)	Other assets (book values) (O)
1. Acro Indemnity Company	New York	$2,252,708 92	$114,082 22	$208,514 79	Nov. 22, 1932	*	*	*	$378 50				*$968 43	$439,223 95
2. Acro Insurance Company	New York	888,141 30	12,021 64	217,560 00	Nov. 22, 1932	*	*	*	261 65				286 88	67,413 55
3. Capital City Surety Company □	New York	1,022,240 00	168,151 96	327,222 84	Feb. 5, 1930								204,694 18	233,982 50
4. Equitable Casualty & Surety Company □	New York	3,291,313 75	2,577,822 65	3,330,349 06	Dec. 31, 1930	$139,181 06	$1,382,823 63	O$864,173 51	122,286 40	89,271 26			*272,068 54	2,685,726 44
5. First Russian Insurance Company [U. S. Branch]	New York	1,688,677 73	14,585 47	275,164 96	Aug. 3, 1925	1,280,067 62	18,300,709 39	O$6,672,916 39	431,918 26	9,362 26				*1,157,989 60
6. Independent Mutual Casualty Insurance Corp. □	New York	488,268 79	27,333 49	464,435 32	Jan. 20, 1933	167,704 98	1,193,966 69	136,360 99	116,681 15	69,271 47	$47,333 51	100 with int.	336,815 36	357,162 10
7. Jefferson Auto Mutual Casualty Insurance Corp. □	New York	393,698 92	18,221 12	482,780 89	Dec. 24, 1931	200,856 77	3,230,957 79	O3,895,164 75	35,266 68	7,894 98			80,663 31	329,267 11
8. Mortgage Guaranty & Title Company of New York	New York	226,672 50		27,686 00	Feb. 20, 1933	401,916 00	11,757,284 96	O823,272 00	47,657 45	3,437 19			*186,663 00	*265,767 88
9. New Jersey Fidelity & Plate Glass Insurance Co.**	Newark	*213,267 14			June 20, 1932	*	*	*	11,455 62	586 43			43,533 00	*272,184 57
10. Southern Surety Company of New York **	New York	5,200,918 80	2,430,293 14	5,961,971 72	Mar. 22, 1932	*	*	*	17,289 46				*1,035,312 14	3,835,357 50
11. Union Mutual Casualty Insurance Corp.◇	New York	389,972 21	60,096 23	686,622 12	May 26, 1931	404,682 00	9,589,139 71	93,541 56	*123,537 84	2,234 00			126,973 11	265,871 20

□ — Reports on disallowed claims have been filed with Supreme Court, New York County.

◇ — First Report and Audit dated May 11, 1932 and Second Report on claims dated September 6, 1932, have been filed with Supreme Court, New York County.

O — Claims filed greatly in excess of possible actual liability of Company.

1-9 {G*, H*, I*} — Claims not adjudicated.

4 N*— Includes cash in banks $176,994.30 attached.

5 O*— Includes $100,000.00 U. S. Govt. Bonds deposited with State of Ohio.

8 {G*, H*, I*} — Claims not adjudicated.

8 N*— Includes trust funds amounting to $42,489.97.

8 O*— Includes mortgages amounting to $255,300.00 held as collateral under Guarantee Agreement.

9 **— Ancillary Proceeding.

9 C*— Represents book value of assets in New York State.

9 {G*, H*, I*} — Claims not adjudicated.

9 O*— Includes assets pledged to secure notes payable amounting to $56,463.75.

10 **— Claims filed aggregating approximately $111,000,000.00 which represents an amount greatly in excess of any possible liability of Company.

10 {G*, H*, I*} — Claims not adjudicated.

10 N*— Includes cash in banks $14,538.79 attached, also $127,597.00 in suspended banks.

11 J*— Includes expenses of Boston Receiver of $15,108.82.

THIS CHECK IS IN PAYMENT IN FULL OF THE WITHIN ACCOUNT AND THE PAYEE ACCEPTS IT AS SUCH BY ENDORSEMENT HEREON IF INCORRECT RETURN CHECK WITH MEMORANDUM OF EXCEPTION.

DATE	PARTICULARS	AMOUNT
	SALARY	

NEW YORK STATE INSURANCE DEPARTMENT
LIQUIDATION BUREAU

No 5451 NEW YORK, SEP 16 1982 19

PAY TO THE ORDER OF Edward McLaughlin $250.

R.A. BRENNAN ★★★★ 250 DOLLARS 00 CTS

To Bank of New York and Trust Company
1-1 48 Wall Street, New York, N.Y.

R. A. Brennan
CHIEF, LIQUIDATION BUREAU

EXHIBIT "C" TO STIPULATION

[fol. 23] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 80,484

EDWARD McLOUGHLIN, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Findings of Fact and Opinion—Promulgated August 19, 1936

Compensation received by petitioner as counsel in the Liquidation Bureau of the Insurance Department of the State of New York, which was paid from the assets of insurance companies, held, not exempt from Federal income tax.

Bernhard Knollenberg, Esq., and Joseph W. Wyatt, Esq., for the Petitioner.

James H. Yeatman, Esq., for the Respondent.

The taxes in controversy are income taxes for the calendar year 1932 in the amount of $224.09. On his return for the calendar year 1932 the petitioner reported a salary of $5,125 from the New York State Insurance Department, but claimed the amount to be exempt from Federal income tax. The respondent held the salary taxable, and determined the deficiency here in controversy. The issue is whether the petitioner is exempt from tax under the implied constitu-
[fol. 24] tional immunity of the instrumentalities of a state from taxation by the Federal Government.

FINDINGS OF FACT

The petitioner is an attorney at law. Prior to 1929 he was associated with a law firm in Brooklyn, New York, and was actively engaged in practice. In 1930 he was appointed by the superintendent of insurance of the State of New York to act as counsel in the liquidation bureau, a branch of the insurance department. He was employed there from the beginning of 1930 until August 2, 1933. During the year 1932 the liquidation bureau maintained three offices in New York City. The main office was in the New York State Building at 80 Center Street, where petitioner was employed during 1932, and there were two branch offices, one at 2 Lafayette Street and the other at 111 John Street,

New York, New York. The petitioner gave full time required of employees in the liquidation bureau, and his hours were from 9 a. m. to 5 p. m., the same as attaches of that bureau who were not engaged in legal work.

After severing connections with the law firm with which he was connected in 1929 petitioner received no further salary from the firm. He maintained office space in their offices and did a certain amount of personal legal work there, such as the preparation of wills, et cetera, all of which was accomplished out of his regular hours with the liquidation bureau. The members of the firm cooperated with him in handling his personal work and the fees received were [fol. 25] divided according to agreement. Petitioner's personal legal fees in 1932 amounted to $1,410 and his office expenses were $570. The greater part of such sum represented fees from matters commenced in 1929, prior to his association with the insurance department. None of the personal legal work that he obtained after becoming associated with the insurance department was the result, either directly or indirectly, of his connection with that department.

The liquidation bureau was created in 1909 and is now known as the "Bureau of Liquidations, Conservations and Rehabilitations." This change in designation occurred sometime in 1933 and was made to make the name of the bureau conform to the description of the title of article II, chapter 191, of the Insurance Laws of the State of New York, which went into effect on March 15, 1932. It will be hereinafter referred to as the bureau. The bureau was in the year 1932 and now is under the charge of a special deputy superintendent of insurance. Said deputy superintendent is a civil service employee of the State of New York, and his salary is paid directly by the state. The bureau also had in 1932 three assistant special deputy superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants. At the beginning of 1932 the bureau had approximately 100 employees and at the end of 1932 the number had been increased to approximately 400, none of whom, with the exception of the special deputy superintendent in charge, were civil service employees. The number of employees varied according to the number of insurance companies under the bureau's jurisdiction.

[fol. 26] The general functions and duties of the bureau are as follows: Under the Insurance Laws of the State of New York the superintendent of insurance of that state may, on certain grounds, apply to the judicial authorities of the state for an order directing him to take over the assets of insurers doing business or in process of organization for the purpose of doing business in the state, for the purpose of liquidating, rehabilitating or conserving the business of such insurers. Upon an order directing rehabilitation, liquidation, or conservation being granted, all of the work necessary to accomplish any of these results is performed by the bureau. When an order is obtained directing the liquidation of an insurance company its charter is dissolved and no new business is transacted. The work of liquidation consists of adjudicating the claims of the creditors of the company, selling the real estate and the other assets, and attempting to collect premiums due. After all of the assets of a company have been realized upon, dividends are distributed pro rata to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company. When an order is obtained directing the rehabilitation of an insurance company the bureau actively operates it (but conducts no new business) and takes steps to remove the causes and conditions which made such proceeding necessary in an effort to bring about its rehabilitation and place the company in a sound financial condition. If the bureau succeeds in rehabilitating the insurer, the assets are turned back to it and it resumes operations under its own direction. If and when it is determined that further efforts to rehabilitate a com-[fol. 27] pany will be futile, the superintendent of insurance may apply for an order of liquidation. No rehabilitation work was done by the petitioner or the bureau in 1932. Although the superintendent of insurance was authorized to apply for rehabilitation orders, no such order was applied for until the year 1933. Upon taking charge of a company for liquidation purposes, certain of the staff of the company such as underwriters and the so-called "production staff" would be dismissed. The key employees would be retained, and the remainder dismissed as soon as practicable. It was the policy of the bureau to centralize the liquidation work as much as possible in one office. The procedure would necessarily vary according to the size of

the companies placed in liquidation, etc. In the case of a very large company its affairs could not be transferred to another office for a long period of time. At the beginning of 1932 the bureau was liquidating 39 insurance companies; at the end of 1932 it was liquidating 11 companies.

In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record. He devoted over 90 per cent. of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office. The balance of his time was devoted to legal problems of the bureau as a whole, such as the drafting of a new article XI of the Insurance Law.

In the year 1932 the department of insurance had a general bank account with the Bank of New York & Trust Co. at 48 Wall Street, New York City. The expenses of the [fol. 28] bureau, including all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account," as simultaneously with the drawing of checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Co. to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the bureau. In drawing checks against the various companies in liquidation to meet petitioner's compensation and the other expenses of the bureau, checks would be drawn by an assistant special deputy of insurance (as representative of the superintendent of insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the bureau kept its separate bank account, and the superintendent of insurance (having charge of all the assets of such company) was in a position to draw checks on the account.

Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted — the affairs of one particular company would be charged against such company. Petitioner's time devoted to the general legal problems of the department would be prorated among the various companies under a formula designed to charge general administration expenses of the department to the

companies in liquidation in proportion to the aggregate [fol. 29] compensation of those engaged in the specific liquidation of the respective companies.

Petitioner's compensation during 1932 was paid bimonthly by check, but was computed on an annual basis. Petitioner did not receive any additional compensation from the insurance department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the superintendent and the compensation did not vary in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the superintendent of insurance.

In the budget of the superintendent of insurance there appeared an item called the reserve fund, for the use of the superintendent in liquidating insurance companies whose assets were not sufficient to pay the cost of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932 and 1933, the amount of the reserve fund was $5,000. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund.

Opinion

ARUNDELL:

This proceeding is in all material respects like that of Clarence M. Freedman, 34 B. T. A. (No. 146), decided this day. The arguments of the parties are along the same lines in both cases and it is unnecessary in this case to repeat our views on the several points urged. It is sufficient to say briefly in this case, as we said at length in the other, [fol. 30] that we are not satisfied that petitioner can be classified as an employee of the state engaged in carrying on an essential governmental function and that in any event the fact of his compensation being from private funds and not from those of the state precludes the allowance of exemption from Federal income tax.

Decision will be entered for the respondent.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 80,484

EDWARD McLOUGHLIN, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the determination of the Board, as set forth in its report promulgated August 19, 1936, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1932 in the amount of $224.09.

Enter:

Entered August 21, 1936.

(Signed) C. Rogers Arundell, Member. (Seal.)

[fol. 31] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

PETITION FOR REVIEW—Filed October 13, 1936

The above named petitioner hereby petitions for a review of the decision of the United States Board of Tax Appeals entered on August 21, 1936 which approved deficiencies in income tax for the year 1932 in the amount of $224.09.

I

Statement of the Nature of the Controversy

Petitioner, a United States citizen, resides in Brooklyn, New York, and filed his income tax return for 1932, with the Collector of Internal Revenue for the First District of New York, whose office is located in Brooklyn, New York. The office of said Collector is located within the jurisdiction of this Court.

On or about March 15, 1935, respondent mailed to the petitioner a notice of deficiency dated on said date for the [fol. 32] year 1932 in the amount of $224.09. Thereafter, and within the period of ninety (90) days from March 15, 1935, petitioner filed a petition for a redetermination of the said deficiency.

The facts were stipulated and on August 19, 1936, the

Board promulgated its opinion in favor of the respondent, the order affirming the deficiency being entered on August 21, 1936. A petition for rehearing and/or reconsideration was denied without opinion September 24, 1936. From the said order and decision, petitioner is appealing to this Court.

The nature of the controversy is as follows:

During the taxable year involved, petitioner was an employee of the Insurance Department of the State of New York, the head of which is the Superintendent of Insurance, a state office created by statute. Petitioner, a lawyer by profession, worked in the Liquidation Bureau, a branch of the Insurance Department, and devoted the full time required of all employees in this Department, his hours being from 9 A. M. to 5 P. M. He received a fixed salary and his remuneration did not depend upon the amount of work he handled in the Legal Department of the Bureau. Petitioner had been connected with a law firm in the year 1929 and subsequent to that date received no further salary from such firm. In 1929, he was appointed Secretary to the then Superintendent of Insurance and in 1930 was requested by the Superintendent of Insurance to act as counsel in the Liquidation Bureau. His employment was pursuant to the statutory authority of the Superintendent of Insurance to [fol. 33] appoint deputies, employ counsel, clerks and assistants. Petitioner, subsequent to such appointment in 1930 and throughout the taxable year, was employed in the Legal Department of the Liquidation Bureau and devoted over 90% of his time to legal problems and cases involving the companies in liquidation whose affairs were being administered by the office of the Bureau located at 80 Center Street, New York City. The balance of his time was devoted to the legal problems of the Bureau as a whole, such as the drafting of a new article of the Insurance Law which became effective in March, 1932.

In the taxable year involved, petitioner received personal legal fees amounting to $1,410 against office expenses of $570. He retained office space with his law firm during the taxable year and did a certain amount of personal legal work, such as the preparation of wills, etc., all of which was accomplished out of his regular hours. In doing such personal work, petitioner got the assistance of one of the members of the law firm to handle or cooperate in the work and the fees were divided according to a mutual agreement with such individual.

The Liquidation Bureau of the New York Insurance Department was created pursuant to statute in 1909 and since some date in 1933 has been known as the Bureau of Liquidations, Conservations and Rehabilitations. The Bureau in the year 1932 (and today) was in charge of a Special Deputy Superintendent of Insurance, a Civil Service employee whose salary is paid directly by the State. Under the New York Insurance Law, when a court order is obtained directing the liquidation of an insurance com- [fol. 34] pany, its charter is dissolved and no new business is transacted.

Petitioner's compensation for the year 1932 was pro rated to the companies in liquidation proportioned to the time devoted by him in connection with such respective companies.

The deficiency in question results from the respondent's ruling that the amount of petitioner's salary received as an employee of the Insurance Department was subject to tax as not being within the constitutional exemption covering state officers and employees. The Board sustained the Commissioner's ruling on this point.

II

Designation of Court of Review

The petitioner resides within jurisdiction of this Court and desires a review in accordance with the provisions of the Revenue Act of 1932.

III

Assignments of Error

Petitioner, as a basis for review, makes the following assignments of error:

1. The Board of Tax Appeals erred in holding:

(a) That petitioner's salary of $5,125 was subject to Federal income tax for the year 1932.

(b) That the Federal Government had the power to tax petitioner's salary received for his services as an employee [fol. 35] of the New York State Insurance Department.

2. The Board of Tax Appeals erred in failing to find as a fact that:

(a) Petitioner was an employee of the State of New York, as distinguished from an independent contractor.

3. The Board of Tax Appeals erred in failing to find from the evidence:

(a) That the Liquidation Bureau of the New York Insurance Department was performing in the year 1932 an essential Governmental function.

(b) That petitioner's services as an employee of the Insurance Department were devoted to carrying out an essential or sovereign function of the State of New York.

4. The Board of Tax Appeals erred in determining the deficiency as aforesaid and in failing to determine there was no deficiency for the taxable year involved.

Wherefore, your petitioner prays that the United States Circuit Court of Appeals for the Second Circuit may review the said decision, opinion, and order and reverse and set aside the same and that the Clerk of the United States Board of Tax Appeals be directed to transmit and deliver to the Clerk of the said court certified copies of all and every [fol. 36] of the documents necessary and material to the presentation and consideration of the foregoing petition for review, as required by the rulings of said court and statutes made and provided.

Bernhard Knollenberg, Attorney for Petitioner, No. 25 Broadway, New York, N. Y.

Duly sworn to by Bernhard Knollenberg. Jurat omitted in printing.

[fol. 37] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PRÆCIPE FOR RECORD—Filed October 13, 1936

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days from the date of the filing of the petition for review in the above entitled case, transmit to the Clerk of the United States Circuit

Court of Appeals for the Second Circuit certified copy of the following documents:

(1) The docket entries of proceedings before the United States Board of Tax Appeals in the case above entitled.
(2) Pleadings before the Board.
(3) Findings of Fact, Opinion and Decision of the Board.
(4) Petition for Review.
[fol. 38] (5) Stipulation of Facts filed herein on October 28, 1935, and Exhibits A, B and C, attached thereto.

The foregoing to be prepared, certified and transmitted, as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

Bernhard Knollenberg, Attorney for Edward McLoughlin.

October 13, 1936.

[fol. 39] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 40] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

EDWARD McLOUGHLIN, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before L. Hand, Swan and Augustus N. Hand, Circuit Judges

Appeal from the United States Board of Tax Appeals

Petition of Edward McLoughlin, a taxpayer, to review an order of the Board of Tax Appeals determining a deficiency of $224.09 in his income taxes for the year 1932. Order affirmed.

Lord, Day & Lord, Attorneys for Petitioner Edward McLoughlin; Bernhard Knollenberg, Jesse Hoyt and Joseph W. Wyatt, Counsel.

James W. Morris, Assistant Attorney General of the United States, Sewall Key and Berryman Green, Special Assistants to the Attorney General, for Respondent.

John J. Bennett, Jr., Attorney General of the State of New York, Henry Epstein, Solicitor-General, and John F. X. McGohey, Colin McLennan and John C. Crary, Assistant Attorneys General, Amici Curiæ.

[fol. 41] AUGUSTUS N. HAND, Circuit Judge:

This is a petition by a taxpayer employed in the Insurance Department of the State of New York at an annual salary of $5,125 to review an order of the Board of Tax Appeals holding his salary for 1932 income subject to taxation under the Revenue Act of that year. In 1930 the taxpayer was appointed by the Superintendent of Insurance to act as legal counsel in the Liquidation Bureau of the Insurance Department and worked daily in that capacity from 9 A. M. to 5 P. M. Outside of these office hours he did a certain amount of legal work for personal clients which, in 1932, yielded $1,410 less $570 office expenses.

The liquidation Bureau was created in 1909 and in 1932 was in charge of a Special Deputy Superintendent of In-

surance who was a civil service employee with a salary paid by the State. During the year 1932 the Bureau had from 100 to 400 employes, including three Assistant Special Deputy Superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants.

Under the New York Insurance Law the Superintendent of Insurance may apply to the court for an order taking over the assets of insurance companies for the purpose of liquidating, rehabilitating or conserving their business. When such an order is made all of the work necessary for liquidation, rehabilitation or conservation is performed by the Bureau. When an order for liquidation of a company is made, its charter is dissolved and no new business is transacted but the assets are liquidated, the claims of creditors adjudicated and dividends are declared to those persons entitled to share in the assets of a defunct insurance com- [fol. 42] pany. When a company is rehabilitated by the Bureau its property is returned to it so that it may resume business under its own management.

The business of the Bureau during 1932 was liquidation to which the taxpayer devoted 90% of his time during that year. The remaining 10% was devoted to legal problems of the Bureau as a whole, such as drafting a new Article XI of the Insurance Law relating to "Rehabilitation, Conservation and Dissolution of Delinquent Insurers."

Among the facts stipulated before the Board of Tax Appeals were the following:

"8. In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. The expenses of the Bureau, including all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account," as simultaneously with the drawing of checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet petitioner's compensation and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the

various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having [fol. 43] charge of all the assets of such company) was in a position to draw checks on the account.

"9. Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted to the affairs of one particular company, would be charged against such company. Petitioner's time devoted to the general legal problems of the Department, would be prorated among the various companies under a formula designed to charge general administration expenses of the Department to the companies in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies.

"10. Petitioner's compensation during 1932 was paid bi-monthly but was computed on an annual basis. Petitioner was paid by check, a form of the check used being annexed hereto as Exhibit 'C'. Petitioner did not receive any additional compensation from the Insurance Department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the Superintendent and the compensation did not vary in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the Superintendent of Insurance.

"11. In the budget of the Superintendent of Insurance there appeared an item called the Reserve Fund, for the [fol. 44] use of the Superintendent in liquidating insurance companies whose assets were not sufficient to pay the costs of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932 and 1933, the amount of the Reserve Fund was $5,000.00. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund."

The salary the taxpayer received for his work in the Liquidation Bureau was held taxable by the Commissioner of Internal Revenue. The action of the Commissioner was

sustained by the Board of Tax Appeals on the ground that the taxpayer was not "an employee of the state engaged in carrying on an essential governmental function and that in any event the fact of his compensation being from private funds and not from those of the state precludes the allowance of exemption from Federal income tax."

The question presented for our decision is whether the taxpayer's compensation as counsel for the Liquidation Bureau and received through such Bureau is subject to federal income tax.

Section 22 of the Revenue Act of 1932 provides that:

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind in whatever form paid, * * *."

Treasury Regulations 77 contained the following provisions:

"Art. 643. *Compensation of State Officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered [fol. 45] in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable."

It is unnecessary for us to deal with the question as to whether the taxpayer when acting as counsel for the Liquidating Bureau was engaged by the State in the exercise of essential governmental powers. It may well be that his activities were essential, like those of a receiver. Jacoby v. Bond & Mortgage Guarantee Co., 72 F. (2d) 420, 423. Irrespective of any such relation to the State there can be no exemption from federal taxation where, as here, taxation would result in no burden upon the governmental power of the State. That the existence of a burden is the test

was the view adopted by the Supreme Court in sustaining the validity of a transfer tax by a State upon United States bonds in Plummer v. Coler, 178 U. S. 115, and in upholding a federal tax upon an estate which included State municipal bonds in Greiner v. Lewellyn, 258 U. S. 384. See also [fol. 46] Snyder v. Bettman, 190 U. S. 249, 253, 254; United States v. Perkins, 163 U. S. 625, and Fox Film Corp. v. Doyal, 286 U. S. 123, 128. By the same reasoning it was held that profits realized by an investor from a sale of municipal bonds were properly taxed under the Revenue Act of 1924, Willcuts v. Bunn, 282 U. S. 216, and that a non-discriminatory privilege tax by the State of Georgia on the business of licensing copyrighted motion pictures was lawful. Fox Film Corp. v. Doyal, 286 U. S. 123. In his opinion in Willcuts v. Bunn, Hughes, C. J., said:

"The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government."

In the case at bar the State in the exercise of its police power is merely using its governmental facilities without expense to itself to aid a private corporation in liquidating insolvent insurance companies in the same way in which chancery receivers or statutory receivers were formerly employed. It is clearly subjected to no burden in any exercise of its sovereignty.

Counsel for the appellant argues, however, that the only situation where the question of a burden upon the public [fol. 47] treasury becomes a relevant factor in determining whether there is a tax exemption is where an independent contractor is employed by governmental authority, such as the consulting engineer engaged by a state as to projects for water supply and sewage disposal whose salary was held taxable in Metcalf & Eddy v. Mitchell, 269 U. S. 514. But no such limitation of the field in which exemptions are

granted because the tax is not a burden is justifiable. The origin of such exemptions is found in the statements of Marshall, C. J., in a case where state taxation of national banks was involved, that "the power to tax involves the power to destroy", and that there is "no power, by taxation or otherwise, to retard, impede, burden, or in any manner to control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government." McCulloch v. Maryland, 4 Wheat. 316, 431, 436. Whatever may be the justification for applying such a rule to taxes which are discriminatory the reason ceases if, as here, the tax in question is ex hypothesi not a burden upon the public treasury. The remote possibility that a tax may affect a state or the United States is not enough to create an exemption. Burnet v. A. T. Jergins Trust, 288 U. S. 508; Greiner v. Lewellyn, 258 U. S. 384; Baltimore Shipbuilding Co. v. Baltimore, 195 U. S. 375; Snyder v. Bettman, 190 U. S. 249; Plummer v. Coler, 178 U. S. 115; United States v. Perkins, 163 U. S. 625; Railroad Company v. Peniston, 18 Wall. 5; National Bank v. Commonwealth, 9 Wall. 353; Thomson v. Pacific Railroad, 9 Wall. 579; Veazie Bank v. Fenno, 8 Wall. 533.

The situations in which exemption from taxation has [fol. 48] not been allowed are: (1) where a State has departed from its usual governmental functions and engaged in business enterprises for the public benefit, Helvering v. Powers, 293 U. S. 214; Ohio v. Helvering, 292 U. S. 360; South Carolina v. United States, 199 U. S. 437; (2) where persons subjected to taxation are neither officers nor regular employes of the State, but are so-called independent contractors, Metcalf & Eddy v. Mitchell, 269 U. S. 514.

We think the justification for denying exemption in each category is that the tax imposes no real burden upon, or impediment to a normal exercise of sovereign power. There will be differences of opinion as to the extent of protection needed against the aggressions of one governmental unit upon another, but there can be no warrant for allowing exemption from a tax which does not burden or impede the exercise of any governmental function.

We find no decisions by the Supreme Court which indicate that employes who receive their compensation from

the avails of a privately owned corporation that is being liquidated by the State are exempt from taxation. On the contrary the recognition of such an exemption would seem to withdraw income from taxation under a fanciful theory of sovereign immunity entirely inapplicable to a federal system of government. Indeed the general allowance of exemptions in similar situations might easily exhaust large sources of income in times of financial depression.

It is argued that our views are contrary to the recent decisions of the Supreme Court in New York ex rel. Rogers v. Graves, 299 U. S. —, and Brush v. Commissioner, — U. S. —. In the first case the salary of the general counsel for the Panama Railroad Company was held exempt from taxation on the ground that the company was a wholly [fol. 49] owned instrumentality of the United States "engaged in maintaining, operating and protecting the Panama Canal." It was said by Sutherland, J., writing for the court, that: "The primary purpose of the enterprise being legitimately governmental, its incidental use for private purposes affords no ground for objection." In the second case the salary of the chief engineer of the Bureau of Water Supply of New York City, appointed under statutory authority with a fixed annual salary of $14,000, was held to be immune from federal income tax because the city in supplying water was exercising an essential governmental function. In each instance it could properly be said that, within the old rule, there was a burden upon a governmental enterprise and not, as here, a taxation of the salary of a State employee engaged in liquidating a private corporation and paid out of its property.

Other decisions strongly relied on by the appellant are Therrell v. Commissioner, 88 Fed. (2d) — (C. C. A. 5), and Hoskins v. Commissioner, 84 Fed. (2d) 627 (C. C. A. 5). In the Therrell case the question was whether bank liquidators who were appointed by the Comptroller of the State of Florida to take charge of the assets of insolvent banks and were subject to dismissal by him, and whose compensation was to be fixed by him at an amount not exceeding 5% of the cash collected, were subject to taxation. A majority of the court held that the salary of such a liquidator was not subject to tax by the federal government because he was an instrumentality appointed

by the State to aid in the administration of its banking laws and to do justice to those interested in an insolvent bank. Judge Hutcheson dissented on the ground that the liquidator was not an officer of the State and drew no [fol. 50] salary therefrom and that: "He merely undertakes for and under the appointment of a Comptroller, as a court receiver does for and under the appointment of a court, to handle specific matters of conservation and liquidation when appointed to do so." Any distinction between the Therrell decision and the case at bar is tenuous but, with all respect, we feel obliged to differ with the decision of the majority.

In the Hoskins case a school district operated a cafeteria for the benefit of its pupils and teachers who alone were allowed to patronize it and were required to pay for food but only at cost. The compensation of the person managing the cafetria was held free from federal taxation for the reason that such taxation would be an interference with a state governmental function. If this decision can be justified it must be only on the theory that a cafeteria was part of the total expense of the district and that the salary of the taxpayer, though payable out of the receipts of the cafeteria, was not to be allocated to that source.

We do not suggest that the Supreme Court would hold that because a State official received his compensation out of fees a federal tax upon it would not be an interference with a State function. But whatever may be said of some situations where compensation is not derived directly from the public treasury we are persuaded that a liquidating agent paid wholly out of the property of an insolvent is not entitled to exemption.

Order affirmed.

[fol. 50½] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Edward McLoughlin against Commissioner of Internal Revenue. Opinion. Augustus N. Hand, C. J.

[fol. 51] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Court House in the City of New York, on the 10th day of May, one thousand nine hundred and thirty-seven.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Augustus N. Hand, Circuit Judges.

EDWARD McLOUGHLIN, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 52] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Edward McLoughlin vs. Commissioner of Internal Revenue. Order for mandate. United States Circuit Court of Appeals, Second Circuit. Filed May 10, 1937. William Parkin, Clerk.

[fol. 53] UNITED STATES OF AMERICA,
Southern District of New York:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 52, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Edward McLoughlin, Petitioner, against Commissioner of Internal

Revenue, Respondent, as the same remain of record and on file in my office.

In Testimony Whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this tenth day of May, in the year of our Lord one thousand nine hundred and thirty-seven, and of the Independence of the said United States the one hundred and sixty-first.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

[fol. 54] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 11, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is assigned for hearing immediately following No. 129.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Black took no part in the consideration and decision of this application.

Endorsed on cover: File No. 41,768. U. S. Circuit Court of Appeals, Second Circuit. Term No. 287. Edward McLoughlin, petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed August 5, 1937. Term No. 287, O. T., 1937.

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IN THE

Supreme Court of the United States

October Term, 1937.

No. 287

EDWARD MCLOUGHLIN,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BERNHARD KNOLLENBERG,
25 Broadway,
New York City,
Counsel for the Petitioner.

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Supreme Court of the United States

October Term, 1937.

No.

EDWARD MCLOUGHLIN,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The Petitioner, by his counsel, hereby prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on May 3, 1937, affirming the decision of the United States Board of Tax Appeals.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 87-8) is reported in 34 B. T. A. 963. The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 89 F. (2d) 699.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 3, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

The question presented is whether the amounts received by the Petitioner as compensation for services as a member of the legal staff of the New York State Insurance Department are subject to federal income tax.

Statutes and Regulations Involved.

The pertinent statutes and regulations will be found in the Appendix, *infra,* pages 9 and 10.

Statement.

Petitioner in 1929 was appointed Secretary to the then Superintendent of Insurance of New York. In 1930 he was appointed a member of the legal staff of the Liquidation Bureau, a branch of the Insurance Department, and continued in this capacity to and through 1932, the taxable year involved (R. 33-34). The term "Liquidation Bureau" has no statutory significance; it is merely a convenient description used to designate those employees of the State Insurance Department who, as a group, are engaged in carrying out the liquidating function of the Superintendent of Insurance.

The Board found as a fact that:

> "The petitioner gave full time required of employees in the liquidation bureau, and his hours were from 9 a. m. to 5 p. m., the same as attaches of that bureau who were not engaged in legal work" (R. 71-72).

The Liquidation Bureau was created in 1909 (R. 37) and its work consists of adjudicating claims, marshalling and liquidating the assets of dissolved companies. After all

of the assets of a company have been realized upon, dividends are distributed pro rata to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company (R. 41). When a court order is obtained directing liquidation of an insurance company, its charter is dissolved and no new business is transacted (R. 41). In the rare instances when there is money left over after payments to policyholders and creditors such balance is distributed to the stockholders of the company (R. 42). In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record and he devoted over 90% of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office of the Insurance Department (the State Building). The balance of his time was devoted to legal problems of the Bureau as a whole, such as the drafting of new Article XI of the Insurance Law (R. 47).

Petitioner's salary was paid bi-monthly by pay checks issued in the name of the New York State Insurance Department, Liquidation Bureau, and signed by the Chief of the Liquidation Bureau, and drawn on the Bank of New York and Trust Company, 48 Wall Street, New York City (R. 51—Ex. C. R. p. 22). The funds deposited in this account out of which petitioner and the other employees of the Bureau were paid were provided by checks drawn on the bank accounts of the various companies in liquidation and in turn deposited with the Bank of New York and Trust Company to the credit of the Liquidation Bureau. Petitioner's compensation for 1932 was pro rated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged (R. 48-49). The time devoted by

him to the general legal problems of the Insurance Department would be pro rated among the various companies under a formula designed to charge general administration expenses to the company in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies (R. 48-51).

In 1932 the petitioner received $5,125 as compensation for his services to the New York State Insurance Department. The Commissioner of Internal Revenue ruled that the compensation was income subject to federal income tax, and, on appeal to the United States Board of Tax Appeals and the United States Circuit Court of Appeals for the Second Circuit, the Board and the Court respectively sustained the Commissioner's ruling.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the respondent from the New York State Insurance Department was subject to Federal income tax.

2. In holding or implying that the function of the New York State Insurance Department in liquidating insolvent insurance companies is a proprietary rather than a governmental function.

3. In holding or implying that because the petitioner's compensation was paid by the New York Insurance Department from funds derived from the assets of the insurance companies in liquidation rather than out of the general funds of the State, the compensation is taxable.

Reasons for Granting the Writ.

1. The decision of the Court below appears to be based on two grounds: First, that the function of the State of New York in liquidating insurance companies is *proprietary* rather than governmental, and second, that because the salary of the petitioner was paid out of the assets of the insurance companies being liquidated rather than out of general funds belonging to the State, the salary is taxable.

a. On the first point—the alleged non-governmental character of the Liquidation Bureau—the Court's decision is in conflict with the decision of the United States Court of Appeals for the Fifth Circuit in *Therrell* v. *Commissioner*, 88 F. (2d) 869 (1937), in which the Court held that Therrell, who was appointed by the State Comptroller of Florida to liquidate a number of insolvent banks in Florida, was not subject to Federal income tax on the commissions received by him for his services as liquidator.*

In petitioning this Court for a writ of certiorari in the *Therrell* case, which petition is now pending, the Solicitor General of the United States stated that:

> "the decision in the instant case is in direct conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *McLoughlin* v. *Commissioner*, decided May 3, 1937 • • •."

---

* The facts of the present case are more strongly in favor of the taxpayer than those in the *Therrell* case because in that case the facts tend to indicate that Therrell was to some extent an independent contractor, and under the decisions of this Court in *Metcalf and Eddy* v. *Mitchell*, 269 U. S. 514 (1926) and *Commissioner* v. *Howard*, 280 U. S. 526 (1929), the compensation received from a state by an independent contractor is taxable. In the present case the Government conceded at the argument before the Court below that McLoughlin was a regular state employee, not an independent contractor.

Petitioner submits that the statement of the Solicitor General as to the direct conflict between the *Therrell* and *McLoughlin* decisions is clearly sound.

b. On the second point—the fact that Petitioner's compensation is paid out of the assets of the insurance companies—the Court's decision in the present case is in conflict with the following decisions in other Circuits:

> *Therrell* v. *Commissioner, supra;*
> *Hoskins* v. *Commissioner,* 84 F. (2d) 627 (1936) (C. C. A. 5);
> *Bettman* v. *Warwick,* 108 Fed. 46 (1901) (C. C. A. 6).

In the *Therrell* case the compensation in question was paid out of the assets of the banks in liquidation; in the *Hoskins* case out of the income of cafeterias in public schools run by the Fort Worth, Texas, School District. In both cases the courts held the compensation was exempt from tax. In the *Bettman* case the Court held that a Federal stamp tax could not be imposed on the certificate issued to a notary public by the State of Ohio, even though his compensation was collected from the persons using his services rather than from the State.

From a statement by the Circuit Court of Appeals for the Second Circuit in the recent case of *Harman* v. *Helvering* (not yet reported), decided June 14, 1937, it appears that even that Court now recognizes that the fact that payment is not made out of state funds is not, a tenable ground for holding the compensation of a state officer subject to Federal income tax. The Court said:

> " * * * it is tempting to say that, as the state's treasury is not concerned, the tax must necessarily be valid. But the cases will scarcely bear out such a test, * * *. It was repudiated in *Bettman* v. *Warwick,*

108 Fed. Rep. 46 (C. C. A. 6), and we refused to base our decision upon it in *McLoughlin* v. *Commissioner*, 88 Fed. (2)."

Furthermore in the recent case of *New York ex rel. Rogers* v. *Graves*, 299 U. S. 401 (1937), this Court held that the salary of the general counsel of the Panama Railroad Company was exempt from New York State income tax because the railroad is an instrumentality of the United States, even though the record showed that the salary was paid out of the earnings of the Railroad Company.

2. The decision of the Court fails to give effect to the distinction drawn by this Court in *Ohio* v. *Helvering*, 292 U. S. 360 (1934), between the *Governmental* and *proprietary* activities of the states. This Court, in sustaining a Federal excise tax imposed upon the liquor business conducted by the State of Ohio, distinguished its decisions in *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, 575 (1931), *McCulloch* v. *Maryland*, 4 Wheat. 316, 436 (1819), and *Collector* v. *Day*, 11 Wall. 113 (1870), by pointing out that:

> "But, by the very terms of the rule, the immunity of the states from federal taxation is limited to those agencies which are of a governmental character. Whenever a state engages in a business of a private nature it exercises non-governmental functions, and the business, though conducted by the state, is not immune from the exercise of the power of taxation which the Constitution vests in the Congress" (p. 368).

If the State of New York should enter the insurance business, as many have urged that it ought to do, such activity would doubtless be classified as proprietary and the compensation paid by the State to those employed in conducting this business would, therefore, be taxable by the Federal Government. *Helvering* v. *Powers*, 293 U. S. 214

(1934). But the present activities of the New York Department of Insurance, including its liquidation of insolvent insurance companies, are purely regulatory and supervisory, *i. e.*, of a truly governmental character, and compensation of its employees engaged in these governmental activities is exempt. *Collector* v. *Day, supra.* There would appear to be less ground for doubt as to the governmental character of the States' function in the present case than in *Brush* v. *Commissioner,* 57 Sup. Ct. 495 (1937) in which this Court held that the compensation received by the Chief Engineer of the Bureau of Water Supply of the City of New York is not subject to federal income tax.

3. The question in this case is of current administrative importance. Similar questions are now pending before the Circuit Court of Appeals for the Third Circuit in *Freedman* v. *Commissioner,* 34 B. T. A. 956, and before the Circuit Court of Appeals for the Sixth Circuit in *Hanrahan* v. *Commissioner,* decided by a memorandum opinion of the United States Board of Tax Appeals on November 12, 1936.

There are a number of other similar cases pending in the United States Board of Tax Appeals which will presumably be appealed to the appropriate Circuit Courts of Appeals unless the issue in the present case is decided by this Court in the near future.

Conclusion.

It is in the public interest that the conflict here presented be resolved by an authoritative decision.

Wherefore, it is respectfully submitted that this petition should be granted.

BERNHARD KNOLLENBERG,
25 Broadway,
New York City,
Counsel for the Petitioner.

APPENDIX.

Statutes and Regulations Involved.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, • • •.

Treasury Regulations 77:

ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable.

New York Insurance Law, Article I § 63 (6):

6. For the purposes of this section, the superintendent shall have power to appoint, under his hand and official seal, one or more special deputy superintendents of insurance, as his agent or agents, and to employ such counsel, clerks and assistants as may by him be deemed necessary, and give each of such persons such powers to assist him as he may consider wise • • •.

Article XI § 414:

Appointment of deputies; employment of assistants; payment of salaries and expenses. 1. For the purposes of this article the superintendent shall have power to appoint under his hand and official seal, one or more special deputy superintendents of insurance, as his agent or agents, and to employ such counsel, clerks and assistants as may by him be deemed necessary, and to give each of such persons such powers to assist him as he may consider wise.

2. The compensation of such special deputy superintendents, counsel, clerks and assistants, and all expenses of conducting any proceeding under this article shall be fixed by the superintendent, subject to the approval of the court, and shall, on certificate of the superintendent, be paid out of the funds or assets of such insurer.

New section. Added by L. 1932, ch. 191, § 1, in effect March 15, 1932.

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IN THE

Supreme Court of the United States

October Term, 1937

No. 287

EDWARD MCLOUGHLIN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

BERNHARD KNOLLENBERG,
JESSE HOYT,
ALFRED C. BENNETT,
JOSEPH W. WYATT,
Attorneys for Petitioner.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER.

Opinions Below.

The opinion of the Circuit Court of Appeals is reported in 89 F. (2d) 699. The opinion of the Board of Tax Appeals is reported in 34 B. T. A. 963.

Jurisdiction.

The judgment of the Court below was entered May 3, 1937. Petition for certiorari was filed August 5, 1937, and granted October 11, 1937. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Constitutional Question Presented.

Is petitioner's 1932 salary for his services as an employee of the New York State Insurance Department subject to Federal Income Tax under the Revenue Act of 1932 in view of the implied constitutional immunity from tax of the compensation of State employees?

Statute and Regulations Involved.

Revenue Act of 1932 c. 209, 47 Stat. 169:

> Sec. 22. Gross Income.
>
> (2) *General Definition.*—"Gross Income" includes gains, profits, and income derived from salaries, wages, of compensation for personal service, of whatever kind and in whatever form paid, * * *."

Art. 643 of Treasury Regulation 77:

> "*Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable. * * *"

Statement of Case.

The issue here presented involves the familiar question as to the right of the Federal Government to tax a state employee. The facts were stipulated and are set forth in full in the record (R. 6-11).

Petitioner was employed during the taxable year (1932) as a member of the legal staff of the Insurance Department of New York State (R. 6). He was employed by the Superintendent of Insurance pursuant to Section 63(6) of the New York Insurance Law, which authorized the Superintendent "to employ such counsel, clerks and assistants as may by him be deemed necessary, and give each of such persons such powers to assist him as he may consider wise". The present statute, Article XI, Section 414(1) of the Insurance Law (effective March 15, 1932) is to the same effect. Counsel for respondent conceded on argument in the Court below that petitioner was a state employee, so this brief will be confined to the remaining issues involved.

Petitioner's services were performed in behalf of a subdivision of the Insurance Department, which at the beginning of the year 1932 was known as the Liquidation Bureau (R. 6). The expression "Liquidation Bureau" has no statutory significance, being merely a convenient description used to designate those employees of the Insurance Department who as a group were engaged in carrying out the liquidating function of Superintendent of Insurance. The Liquidation Bureau was created in 1909 (R. 7) and its work consists of adjudicating claims, marshalling and liquidating the assets of dissolved companies (R. 8). When an order is obtained directing the liquidation of an insurance company its charter is dissolved and no new business is transacted (R. 8). Petitioner devoted 90% of his time during the year

in question to legal problems and cases involving the companies in liquidation, whose affairs were administered at the 80 Center Street Office of the Insurance Department, maintained in the State Building, New York City (R. 9). The balance of his time was devoted to the problems of the Bureau as a whole, such as the drafting of new Article XI, of the Insurance Law (R. 9).

In the statute authorizing petitioner's employment the method of providing funds for his compensation, as well as for the other persons employed to assist the Superintendent in the work of liquidation, was provided for as follows:

> "The compensation of such special deputy Superintendents, counsel, clerks and assistants, and all expenses of taking possession of and conducting the business of liquidating any such corporation shall be fixed by the superintendent, subject to the approval of the court, and shall, on certificate of the superintendent, be paid out of the funds or assets of such corporation." Sec. 63 (6) N. Y. Insurance Law.

New Article XI, Section 414(2) (effective March 15, 1932) *is to the same effect. This provision of the statute declaring* petitioner's salary payable out of the assets of the companies in liquidation appears to be clearly the reason for the ruling of the Commissioner of Internal Revenue that his salary was taxable and also for the decisions of the Board and the C. C. A. affirming petitioner's deficiency. As will be developed *infra*, it appears that this element as to the source of petitioner's compensation is a novel aspect of the constitutional principle of immunity from tax that is presented for the first time to this Court.

Summary of Argument.

The index of this brief embodies a summary of the argument presented on behalf of the petitioner.

I.

Petitioner is immune from Federal tax, being a State employee engaged in the administration of the New York Statute governing the liquidation of insurance companies.

The doctrine of implied constitutional immunity from tax, inuring to the Federal Government as against the states and to the states against the Federal Government, has been applied in a long line of cases ever since the foundation of the principle in *McCulloch* v. *Maryland* (1819) 4 Wheat. 316. A review of the many decisions of this court and the lower Federal courts show, while it has been impossible to formulate any all inclusive rule, that nevertheless certain principles can be deduced in respect to the taxation of Federal or State employees. A state may not tax an officer of the Federal Government (*Dobbins* v. *The Commissioners* (1842) 16 Peters 435) and the immunity is reciprocal in favor of a state officer (*The Collector* v. *Day* (1870) 11 Wall 113). The Federal Government however, has the power to tax an enterprise of a business nature even though carried on by the State, because under such circumstances the State is not exercising a governmental but rather a proprietary function (*South Carolina* v. *U. S.* (1905), 199 U. S. 437). When a State is thus carrying on a proprietary enterprise the salaries of those conducting it are not exempt from tax

(*Helvering* v. *Powers* (1934) 293 U. S. 214). If the nature of the enterprise however is truly *Governmental* (whether styled usual or essential) immunity exists and is absolute. *Indian Motocycle Co.* v. *U. S.* (1931) 283 U. S. 570 at 575; *Trinity Farm Co.* v. *Grosjean* (1934) 291 U. S. 466 at p. 471. The opinion of this court in *Brush* v. *Commissioner* (1936) 300 U. S. 352, refuted the idea set forth in the reversed C. C. A. decision (85 F. (2d) 32) that the function had to be literally *traditional* or *exclusively* within the *power* of a state to conduct in order to be immune.

It is unnecessary to give citations to establish the fact that in the long line of cases considered by this court, inquiry has been confined (when a tax on bona fide state employees was concerned) to the *nature* of the state activity involved. If both state employment and the proper Governmental function have been found to exist, this court has upheld the principle of immunity.* Neither the decision of the Board or that of the Court below took issue with the contention that petitioner was engaged in a proper Governmental function from the viewpoint of tax immunity although the point was argued at length in the briefs submitted in petitioner's behalf. The Court below stated it was "unnecessary" to deal with this question (p. 701). Respondent expressly recognized the proper Governmental function of employees of the bureau when holding their salaries non-taxable in his ruling of October 18, 1933, reading as follows:

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* Cases involving independent contractors such as *Metcalf & Eddy* v. *Mitchell* (1926) 269 U. S. 514, and taxes *indirectly* affecting the exercise of a State or Federal function such as *Willcuts* v. *Bunn* (1931) 282 U. S. 216, involve another aspect of this question and do not control where "state employee" relationship exists.

"Mr. Richard A. Brennan,
Special Deputy Superintendent,
State of New York Insurance Department,
80 Centre Street,
New York, New York.

Sir:

Reference is made to the letter addressed to you under date of November 3, 1932, in regard to the taxable status, for Federal income tax purposes, of the compensation received by employees of the *Liquidation Bureau of the New York State Insurance Department*, hereinafter referred to as the Liquidation Bureau.

In that letter it was held that the compensation of such employees was subject to Federal income tax, as the activities of the liquidation Bureau fell within the class of proprietary activities as distinguished from activities which are essentially governmental in nature. That ruling has been reconsidered by this office. Upon reconsideration it has been held that as the general supervision of insurance companies by a state constitutes the discharge of an essential governmental function and as the taking over of insolvent insurance companies for operation and liquidation by the state in accordance with the provisions of the state statute apparently constitutes an integral part of such supervision, the liquidation of insurance companies by the Liquidation Bureau constitutes the discharge of an essential governmental function. Accordingly the compensation of those individuals who are regularly and continuously employed by the Liquidation Bureau (as distinguished from those who are engaged to perform a particular service, such as the service which might be performed by a practicing attorney who is called upon by the Liquidation Bureau to render legal services for it in connection with the accomplishment of a specific object), that is the bonafide employees of the liquidation Bureau, *is exempt from Federal income tax.* The ruling of

November 3, 1932 is modified in so far as inconsistent herewith.

Respectfully,

GUY T. HELVERING,
Commissioner."

This ruling was subsequently revoked by the ruling of February 13, 1935 on the ground however that the compensation was paid from the assets of the companies and not because of the nature of the Bureau's function.

"Mr. Richard A. Brennan,
Special Deputy Superintendent,
State of New York Insurance Department,
80 Centre Street,
New York, New York.

Sir:

Further reference is made to the rulings rendered on November 3, 1932, and October 18, 1933, respecting the taxable status, for the purposes of the Federal income tax, of the compensation received by employees of the Liquidation Bureau of the New York State Insurance Department.

In the letter of October 18, 1933, it was held, after reconsideration of the question at issue, that as the general supervision of insurance companies by a state constitutes the discharge of an essential governmental function and as the taking over of an insolvent insurance company for operation and liquidation by the state in accordance with the provisions of the state statute apparently constitutes an integral part of such supervision, the liquidation of insurance companies by the Liquidation Bureau constitutes the discharge of an essential governmental function. It was further held that the compensation of those individuals who are regularly and continuously employed by the Liquidation Bureau (as distinguished from those who are engaged to perform particular ser-

vices, such as the service which might be performed by a practicing attorney who is called upon by the Liquidation Bureau to render legal services for it in connection with the accomplishment of a specific object) that is, the bona fide employees of the Liquidation Bureau, was exempt from the Federal income tax. The ruling of November 3, 1932, was modified accordingly.

Upon consideration of a similar question presented in the case of a bank liquidator, it was held (G. C. M. 13488, published in I. R. B. XIII-35, page 9) that where liquidators are engaged to render services in connection with the liquidation of a bank by the Banking Department of the State of Florida *and their compensation is paid from funds or assets of the bank being liquidated,* such compensation must be included in gross income for Federal income taxation as to subject it to the Federal income tax will not so burden the state as to constitute an interference by the Federal government, through taxation, with the discharge of an essential governmental function by the state. Because of the similarity of the functions of a liquidator to those of a receiver, your attention is directed to the decision rendered in the cases of Wright v. Commissioner, 29 B. T. A. 1267 and Abbott v. Commissioner, 30 B. T. A. 227. To subject the compensation received by liquidators of insurance companies to the Feleral income tax would not so burden the state or political subdivision as to constitute an interference by the Federal government, through taxation, with the discharge of an essential governmental function of the state or political subdivision.

It is apparent that the case under discussion is similar to the ruling contained in G. C. M. 13488, supra. Accordingly, it must be held that compensation received by employees of the Liquidation Bureau of the New York State Insurance Department constitutes income subject to the Federal income tax.

The ruling of October 18, 1933, is accordingly modified insofar as inconsistent herewith.

Respectfully,

GUY T. HELVERING,
Commissioner.

RLB/IM-I"
(Italics ours.)

Under such circumstances counsel for petitioner feel justified in only commenting briefly on the Governmental function element before considering what we consider to be the vital point involved, viz., the source of petitioner's compensation.

A state under its police power has the exclusive control and regulation of insurance companies.

From the earliest days the great public interest involved in insurance has necessitated Governmental supervision in some form. The history of Governmental regulation in Europe, England and this country is discussed in The Insurance Commissioner in the United States, Patterson (1927) pages 513-537. This court has repeatedly held that the insurance business is one which a state may regulate in the interest of the public under its police power,* and that a state may regulate a business for the protection of the public although the nature of the business itself is not governmental (*Ambrosini* v. *United States* (1902) 187 U. S. 1). It is also firmly established that the police power continues throughout liquidation (See *Matter of Bond & Mortgage Guarantee Company*, N. Y. Supreme Court (1935) 157 Misc.

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* *Merchants Mutual Auto Co.* v. *Smart*, 267 U. S. 126 (1925); *N. Y. Title & Mortgage Co.* v. *Tarver*, 51 F. (2d) 584 (1931); aff'd 285 U. S. 524; *O'Gorman and Young, Inc.* v. *Hartford Fire Ins. Co.*, 282 U. S. 251 (1931); *LaTourette* v. *McMaster*, 248 U. S. 465 (1919); *German Alliance Ins. Co.* v. *Hale*, 219 U. S. 307 (1911).

240 at 242). Compare *In re Union Guarantee & Mortgage Company* (1935) C. C. A. 2, 75 F. (2d) 984, (cert. denied 56 S. C. 142), opinion of the C. C. A. at page 984:

> "The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise."[1]

This same principle has also been affirmed by the state courts. See *Mitchell* v. *Taylor* (Supreme Court California 1935) 3 Cal. 2nd 217) where the court discussed the function of the insurance commissioner of California while acting as liquidator.

> "There can be no doubt that the statute was enacted under the police power for a purpose connected with the public interest; that the legislature has declared the liquidation of insolvent insurance companies a matter in which the state has an interest; and that consequently it has made provision for a state officer to protect and advance that interest. The Insurance Commissioner is not a mere private trustee, or receiver wholly dependent on the appointing court for his powers. He is a state officer, performing duties enjoined upon him by statute, and in their performance he acts on behalf of the state" (p. 219).[2]

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[1] Compare *Hopkins Savings Assn.* v. *Cleary* (1935) 296 U. S. 315, 337, as to exclusive state control over building and loan associations and *Chicago Title & Trust Company* v. *Forty-One Thirty-Six Wilcox Building Corporation* (October Term, 1937), (Nos. 23, 24, U. S. where this Court stated "How long and upon what terms a state-created corporation may continue to exist is a matter exclusively of state power" (p. 4, stenographic copy of opinion).

[2] To the same effect see the following: *State* v. *Hall* (Supreme Court Mo. (1932) 52 S. W. (2d) 174; 330 Mo. 1107); *State* v. *Farm & Home Savings & Loan Assoc.* (Sup. Ct. Mo. 1936), 90 S. W. (2d) 93, 96; *People* v. *Niehaus* (Sup. Ct., Ill. 1934) 356 Ill. 104; 190 N. E. 349, 352; *O'Malley* v. *Hankins* (Sup. Ct., Ind., 1935) 194 N. E. 168; *Clark* v. *Williard* (1933), 292 U. S. 112, 120.

This court has recognized the governmental nature of the police power function. In its opinion in *Ohio* v. *Helvering* (1934) 292 U. S. 360, the following statement appears at page 369:

> "Nevertheless, the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on. * * * When a state enters the market place seeking customers it divests itself of its *quasi* sovereignty *pro tanto*, and takes on the character of a trader, so far, at least, as the taxing power of the federal government is concerned."

The fact that the charters are dissolved of all companies in liquidation (R. 8) necessarily eliminates the "seeking of customers". New York State has not undertaken to carry on the business of insurance, but merely has taken over liquidation to protect the great public interest involved.* The long line of cases that can be classified as involving "proprietary enterprises" conducted by a state are clearly distinguishable. These all involved the element (not present in our case) of *operation* of a *business* for profit in some form.

The great public interest in the insurance business first made necessary the supervision and regulation of insurers as going concerns and in the year 1909 the New York State Legislature determined it was necessary for the state to extend its supervisory powers to include the conduct of liquidation proceedings.

The statute under which the control of liquidation was given to the Insurance Department was enacted as a result of a message to the legislature by the present Chief Justice,

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* Compare G. C. M. 14952 (XIV-2 C. B. 130) holding the compensation of officers and employees of the state compensation insurance fund of California taxable on the ground that "The State is *not* limiting its activity to regulating the business but is engaged in carrying it on" (p. 134—Italics ours).

then Governor of the State of New York, under date of March 8, 1909. Governor Hughes' message in part stated as follows:

> "The serious delays and enormous waste connected with receiverships, both of banking and of insurance corporations, has directed attention to the advisability of providing suitable means for economical and speedy liquidation through the agency of the respective State departments. Last year the Banking Law was amended so as to provide for liquidation of banking corporations by a business-like method, and the wisdom of the provision has already been demonstrated by experience. Similar exigencies arise in connection with insurance corporations and should be dealt with in a similar way." (See Senate Documents 132nd Session, Vol. V, No. 26).

This power of the state to conduct liquidation has always existed, although not exercised until 1909. As this court stated in *Brush* v. *Commissioner, supra,* at page 371:

> "Governmental functions are not to be regarded as non-existent because they are held in abeyance, or because they lie dormant, for a time. If they be by their nature governmental, they are none the less so because the use of them has had a recent beginning."

The Superintendent of Insurance represents the State in liquidation proceedings.

At the head of the New York Insurance Department is the Superintendent of Insurance whose duty is to administer the insurance law. In *Matter of Casualty Co. of America* (Rubin Claim) (1927) 244 N. Y. 443, CARDOZO, *Ch. J.*, referred to the liquidating function of the Insurance Department and the Superintendent of Insurance in the following language (p. 447):

> "The liquidation of insurance companies in this State is governed by a statute adopted, in its main

features, in 1909. The system of liquidation by receivers specially appointed had proved to be dilatory and wasteful. The Legislature substituted administration by a department of the government. Upon the application of the Superintendent of Insurance, an order may be made by the Supreme Court for the liquidation of the business. The work is to be done by the Superintendent and his deputies, but under the supervision of the court, and subject to its direction. 'Such liquidation shall be made by and under the direction of such superintendent, and his successors in office, who may deal with the property and business of such corporation in their own names as superintendents, or in the name of the corporation, as the court may direct' (L. 1909, ch. 300, Sec. 63, subd. 3)."

Compare *Matter of Union Bank* (1912) 204 N. Y. 313, at 322 as to the status of the Superintendent of Banks.

This court in *Relfe* v. *Rundle* (1880), 103 U. S. 222, recognized the status of the Missouri State Superintendent of Insurance as that of a state officer when acting as Liquidator (p. 225).

> "He is an officer of the State, and as such represents the State in its SOVEREIGNTY while performing its public duties connected with the winding up of the affairs of one of its insolvent and dissolved corporations. His authority does not come from the decree of the court, but from the statute." (Capitals ours.)

Compare *Greenfield Savings Bank* v. *Commonwealth* (1912), 211 Mass. 207, in connection with the status of the Bank Commissioner of Massachusetts, also *in re Chetwood* (1896), 165 U. S. 443, where a receiver of a national bank appointed by the comptroller of the currency was said to be

"the agent and officer of the United States" (p. 458). Insofar as being engaged on a governmental function is concerned petitioner is in the same status as the Superintendent, being merely a statutory assistant performing legal services for the superintendent. (Compare *Therrell* v. *Commissioner* (1937), C. C. A. 5, 88 F. (2d) 869, 872.)

In New York the State alone can conduct liquidation through the Liquidation Bureau of the Insurance Department. Even solvent companies must be thus liquidated (*Reed* v. *Squire*, 1st Dept., A. D. 1926-217 A. D. 494, 497). It is respectfully submitted that petitioner was engaged in carrying out a governmental or sovereign function of the State, and that the immunity of his compensation from Federal income tax is *absolute* within the principle of the cases referred to.

II.

Petitioner's immunity from tax is not nullified because the New York statute provides that the assets of the companies in liquidation shall be used to pay his salary.

G. C. M. 13488 is a new and unsound ruling under which the element of the source of an employee's compensation is made a decisive test of immunity.

Prior to G. C. M. 13488 (XIII-2 C. B. 156) promulgated December, 1934, the Commissioner of Internal Revenue consistently ruled that the source of compensation was immaterial on the question of immunity from tax of the salaries of state employees. See the following:

O. D. 1053 (5 C. B. 106)—(Fees of deputy sheriffs);

I. T. 1316 (I-1 C. B. 105)—(Compensation of deputy bank examiners appointed by a state bank examiner and paid out of the assets of insolvent banks);

I. T. 1693 (II-1 C. B. 72)—(Fees of public administrators);

I. T. 2030 (III-1 C. B. 117)—(Fees of public administrator in Montana);

I. T. 2214 (IV-2 C. B. 46)—(Compensation of receiver of insolvent Kansas bank);

G. C. M. 60 (V-1 C. B. 45)—(Compensation of secretary of Kansas State Fair Board paid largely from fair earnings);

G. C. M. 11625 (XII-1 C. B. 69)—(Fees of special masters in chancery in Illinois);

I. T. 2710 (XII-2 C. B. 79)—(Employees of state banking depart. paid out of insolvent bank assets).

I. T. 1316 ruled as follows:

> "The compensation of the special deputies of course comes out of the assets of the bank or trust company, but the source of compensation is not important, for as was said in *Bettman* v. *Warwick* (108 Fed. 46), cited in Law Opinion 382, it is for the government which makes the appointment to determine how the compensation shall be paid."

The Treasury Regulations up to and including Art. 643, Reg. 77 (1932 Act) similarly did not limit the immunity of state officers and employees to situations where their compensation was paid directly by the state or a political subdivision thereof. There is nothing in Art. 643, Reg. 77, to preclude petitioner's immunity because his salary is not

raised by the usual method of taxation. The provisions of this regulation (insofar as relevant) are the same as the regulations promulgated in connection with the prior revenue acts, see Reg. 75 (1928 Act); Art. 88, Reg. 69 (1926 Act); Art. 88, Reg. 65 (1924 Act); Art. 88, Reg. 62 (1921 Act); Art. 85, Reg. 45 (1918 Act); Art. 5 (g), Reg. 33, (1917 Act). When we come to the latest regulation (Reg. 94, Art. 116-2) however, we find a changed attitude on the part of the Treasury, and the new regulation states that compensation is taxable unless received "from the State or political subdivision as an officer or employee thereof * * *".

It is pertinent to inquire into the history and basis for this changed attitude on the part of the Commissioner and the Treasury Department as expressed in the new regulation above referred to, which adds a completely new element to the principle of immunity from tax of state officers and employees.

The origin of this new theory as to the element of the source of compensation is to be found in G. C. M. 13488, *supra*. This ruling was clearly an attempt to graft a new element by way of limitation to the principle of immunity. The ruling involved the compensation of a "special" bank liquidator in Florida. It first states that the taxpayer was not a state officer and casts doubt on his employee status, comparing his relationship with the state to that of an independent contractor. After quoting at length from *Metcalf & Eddy* v. *Mitchell, supra*, the ruling states that even if the "special" bank liquidator were a state employee, nevertheless he was not exempt from tax, because

> "* * * it is certain that a tax upon his income cannot be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way. No such interfer-

> ence could result with respect to this taxpayer since the compensation was not paid by the State, but by the bank which was being liquidated. * * *"

and concludes as follows:

> "In view of the decision of the Supreme Court in the *Metcalf & Eddy* case, it seems reasonably certain that that court will not extend the exemption to income which is not received from a State or political subdivision where the taxation of the income will in no way *burden* the state." (Italics ours.)

This ruling is clearly based on the thought that in order to spell out a "burden" resulting from income tax the *treasury* * of a state or political subdivision thereof must be affected.

The only case cited in the ruling on the source of compensation point is *Miller* v. *McCaughn*, C. C. A. 3 (1928) 27 F. (2d) 128 (affirming 22 F. (2d) 165). As this case will presumably be relied upon by counsel for the Commission it is in order to refer briefly to it. The cited case involved the taxability of an examiner or auditor appointed by a state court to report to it the financial standing of corporations applying to be approved as sureties on court bonds. The compensation was provided out of moneys deposited by the surety companies with the clerk of the court. The United States Circuit Court of Appeals for the Third Circuit affirmed the district court and held the compensation taxable. The court held that "in no sense can such examiner be regarded for income tax exemption as an officer or employee of the State of Pennsylvania", and in reaching this conclusion merely commented on the fact that the examiner received no pay from the State. As stated in

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* To same effect see opinion below of the C. C. A. at page 701.

the opinion of the court at page 128, the contention of the government was that the taxpayer did not come within the income exemption provision of an "officer or employee of state or political subdivision thereof". While G. C. M. 13488 quotes from the district court opinion in *Miller* v. *McCaughn* the real basis for the *upper* Court's decision was that the officer or employee relationship had not been established. The brief of the Commissioner on appeal did not even maintain that the source of compensation was material. The facts show the funds were *voluntarily* deposited by the surety companies and the true situation would appear to be that the *companies* employed the auditor who had merely been designated by the court to act in such capacity.

The cited case was analyzed by the Board of Tax Appeals in *David K. Cochrane, Petitioner* v. *Commissioner* (1932), 26 B. T. A. 1167 at 1171-1172:

> "We think that *Miller* v. *McCaughn*, supra, is not authority for the proposition that the source of the income of a state officer alone determines its taxability by the Federal government." (Citing and quoting *Bettman* v. *Warwick*, 102 Fed. 127; affirmed 108 Fed. 46.)
>
> "In many of the States the so-called fee system is widely employed as a means of providing compensation for State, county and municipal officers employed in the performance of duties clearly of a strictly governmental nature. The alternative of the fee system would necessarily require the payment of the compensation of these officers out of public funds."

A recent case shows conclusively that the Circuit Court of Appeals for the Third Circuit did not base its decision in *Miller* v. *McCaughn* on the source of compensation element.

(See *Freedman* v. *Commissioner* (1937), C. C. A. 3rd, 92 Fed. (2d) 150, referred to *infra,* page 21 of this brief).

After the promulgation of G. C. M. 13488 (based on the theory of the "independent contractor" doctrine) the Commissioner applied the ruling to situations where bona fide employees were concerned, such as in petitioner's case. The prior rulings were revoked and additional rulings were made applying the "source of compensation" idea expressed in G. C. M. 13488. (See G. C. M. 14116; XIV-1 C. B. 102 ruling taxable the compensation of a public administrator of a county in Massachusetts whose compensation was paid out of the assets of the estates administered; also G. C. M. 14957; XIV-2 C. B. 130 ruling taxable the fees received by notary publics in the State of Louisiana where the fees were paid by the individuals employing the notaries.) The present attitude of the Commissioner and the Treasury Department on this whole subject is now set forth Mim. 3838; XV-1 C. B. 130.

The vague expression in G. C. M. 13488 that exemption fails where compensation is paid out of the assets of a closed bank (or similarly an insurance company) because under such circumstances no "burden" is placed on the state, has since been adopted by the Board of Tax Appeals in various of its decisions, viz.: *Freedman* v. *Commissioner,* 34 B. T. A. 956 (reversed C. C. A. 3rd, *supra*). The same expression was seized upon by the Court below in affirming petitioner's deficiency and in fact constitutes the entire *ratio decidendi* of the opinion, viz.:

> "We think the justification for denying exemption in each category is that the tax imposes no real burden upon, or impediment to a normal exercise of sovereign power" (p. 702).

At page 703 the opinion concludes as follows:

> "But whatever may be said of some situations where compensation is not derived directly from the public treasury we are persuaded that a liquidating agent paid wholly out of the property of an insolvent is not entitled to exemption."

The theory of G. C. M. 13488 was rejected by the C. C. A. 5th in *Therrell v. Commissioner*, and by the C. C. A. 3d in *Freedman v. Commissioner*.

In *Therrell* v. *Commissioner, supra,* the court rejected the reasoning in the ruling and stated as follows, on the identical facts:*

> *"The liquidator cannot by the United States be taxed on his employment to any extent. If anything is taken from him as tax, he would lack that much of receiving what the state law allows him.* Compare *Dobbins* v. *Erie County,* 16 Pet. 435, 10 L. Ed. 1022, where the compensation of the captain of a United States revenue cutter was involved and *Hoskins* v. *Commissioner* (C. C. A.) 84 F. (2d) 627, where the salary of a superintendent of a state public school cafeteria was sought to be taxed. The tax assessed here cannot constitutionally be sustained" (p. 872). (Italics ours.)

The Board of Tax Appeals in deciding petitioner's case did so on the authority of its opinion simultaneously issued in *Freedman* v. *Commissioner* (34 B. T. A. 956), stating it was unnecessary to repeat its views as petitioner's case was in all material respects similar to the *Freedman* case. The decision of the Board in the *Freedman* case was reversed,

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* Different taxable years being the only difference.

however, by the Third Circuit. The court disposed of the source of compensation point as follows:

> "* * * the quantum of the employee's pay, *the means by which he is paid,* are features which do not on the other hand determine the liability of the national employee to state taxes or the state employee to Federal taxes * * *" (p. 152). (Italics ours.)

The quantum of interference to a State from Federal Income Tax on its employees and the source of their compensation is of no consequence.

Counsel submit that G. C. M. 13488, *supra* (as construed to apply to state employees), is unjustified by precedent and is based on a misconception of the very roots of the constitutional principle involved. The quantum of the interference of a sovereign state's activities resulting from a tax, is of importance only when testing the constitutionality of a tax on independent contractors (*Metcalf & Eddy* v. *Mitchell, supra*) or a tax *indirectly* connected with the exercise of a state function, viz. (*Willcuts* v. *Bunn, supra*)[1]. When the tax, however, is *directly* imposed on the exercise of a governmental function (such as a tax on an officer or employee), the amount of the tax in question, the justness of the tax, or the quantum of resulting interference to the state is of no consequence.[2] In the language of the court in *U. S.* v. *Railroad Company* (1872), 17 Wall 322,

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[1] The cases cited in the opinion of the C. C. A. below (p. 701) illustrating the alleged "burden" test all involve taxes with an indirect connection with a State function.

[2] The briefs submitted to this Court in behalf of the Commissioner in *Lucas* v. *Howard* (1929) 280 U. S. 256, and *Lucas* v. *Reed* (1930) 281 U. S. 699, conceded this principle. Brief in *Howard* case at pages 17 and 18. Brief in *Lucas* case at pages 22 and 23.

> "* * * the beginning of such taxation is not allowed on the one side, is not claimed on the other" (p. 328).

Again as stated in *Indian Motocycle Co.* v. *U. S. supra,* at page 575:

> "Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is *absolute* * * * citations." (Italics ours.)

The Circuit Court of Appeals for the Second Circuit recognized the rule in *Commissioner* v. *Ten Eyck* (1935), 76 F. (2d) 515, 519,

> "Where immunity exists, it rests upon an entire absence of power to tax."

The case of *The Collector* v. *Day, supra,* was the first case which involved the constitutionality of an *income* tax in respect to a state officer. In holding the tax unconstitutional, the court did not consider the *weight* of any "burden" on the Treasury of the State of Massachusetts resulting from the income tax assessed against the state probate judge, but merely affirmed the principle implied in the previous cases that the Federal Government lacked power to tax, in any way, a state officer. The very statement that inquiry must be made as to the effect on a state's treasury of the imposition of Federal income tax on an employee would seem to demonstrate the fallacy of such theory. Income taxes are paid out of the pockets of the individual taxpayers and no part of the tax ever comes out of the treasury of a state or a political subdivision thereof.

The argument will presumably be made by counsel for the Commissioner that when a state officer or employee is

paid out of the state treasury, the inference is that if such officer had to pay a Federal income tax, the state would have to raise his salary and that consequently the state treasury in the last analysis would be depleted. Such reasoning has never been relied on by this court in the many cases holding income taxes unconstitutional on either Federal or State employees. The presumption is purely guess work and would constitute a tenuous basis for an important and far reaching principle of law. If the reason for the rule were based on any such presumption it would be equally applicable in the "independent contractor" cases illustrated by *Metcalf & Eddy* v. *Mitchell, supra, Lucas* v. *Reed, supra,* etc. If the presumption exists it would follow that an income tax on "independent contractors" would directly affect a state's treasury because of the necessity of paying additional compensation and the contractor's compensation would therefore be exempt. The existence of any such presumption, however, was impliedly denied by this court in reversing without opinion the Third Circuit in *Lucas* v. *Reed, supra,* in which the taxpayer in his brief to this court contended (at p. 14) that:

> "If it were ruled that a lawyer's compensation for services rendered in a matter of government and sovereignty is subject to a substantial Federal tax, it would doubtless be obliged to pay more for the lawyer's services than if his compensation were not subject to federal taxation. If the compensation of a state servant be subject to federal taxation, the effect is for the State itself to pay the tax."

The fee system is still used in many States to provide compensation for State officials or employees.

The theory for denial of immunity advanced by the commissioner and followed by the court below would create a wholly unwarranted distinction between state paid salaries and the fee system which latter still prevails in many states.

There are so many different methods of compensating state employees it would be beyond the scope of this brief to attempt to itemize the system used by one state, let alone the system followed by all the forty-eight states. New York state officers and employees, however, can be generally classified as follows:

(1) Officers and employees of the state itself.

(2) Officers and employees of a territorial subdivision, such as a county.

(3) Local officials employed by a city, village, town, etc.

(4) Those employed by a state corporate instrumentality such as the Bureau of Water Supply of the City of New York.

Generally speaking it may be said that the salaries of the officers of the state itself are fixed either in the state constitution or by statute and their salaries are paid out of general funds of the state raised through taxation. When we come to the next class, or those employed by a county or district, we usually find that while certain officials such as county judges and public administrators, are compensated by salaries which are county or district, etc., charges, the salaries of the remaining officials both as to amount and method of payment are determined by some county or district authority such as the Board of Supervisors in New

York (McKinney's Consolidated Laws of New York) (County Law, § 12 (5)). Similarly the local officials or employees of a town and village have their compensation provided for by local boards, such as the town boards in the State of New York. (See McKinney's Consolidated Laws of New York, Volume 61, Town Law, § 27.) This amendment effective January 1, 1934, substituted a salary system for the payment of town officers subject to the section.

From the earliest days the recognized representatives of the sovereign received their sole compensation from fees. One excellent illustration is that of the sheriff in early English history, who was entitled to specific sums for specific services. (See Murfree on Sheriffs' Second Edition (1890), § 1065.) The sheriff in New York County was formerly compensated by a salary plus one-half of fees (Laws 1890, Chapter 523, § 1, as amended by Laws 1913, Chapter 373, I D § 2), but now receives a straight salary under the present statute. (Chapter 558, New York Laws of 1919.) Public administrators in some states are still compensated on the fee basis such, as the Public Administrator in Erie County, New York (N. Y. C. P. A. §125), and there are innumerable other examples of minor officials such as county clerks, county treasurers, tax collectors,[1] justices of the peace, constables, district attorneys, recorders, marshalls, port wardens[2] who receive their compensation either in whole or in part from fees collected directly from the public who make use of their services.

In some states salaried officials are allowed to collect and retain fees in payment of their salaries, paying only the excess of the fixed salary into the treasury of the county or district, etc., as the case may be. In Maryland under Article

[1] See McKinney's Cons. Laws of N. Y., Vol. 59, Tax Law § 81.
[2] See Maine Revised Statutes 1930, Chapter 48, p. 774, § 13.

III, Sec. 45 of the State Constitution, the compensation of Clerks of Courts and Registers of Wills, while limited to a fixed sum, is nevertheless derived from fees (Ann. Code of Md. (Bagby) Vol. 1, at p. 101) and parties to a civil suit are directly liable to a clerk for costs, *M. & C. C. of Balto.* v. *Pattison* (1920) 136, Md. 64, 68.* See also Code of Iowa (1935) Title XXIX, Justices of the Peace, Chapter 475, § 10639, providing that fees in excess of specified sums to be paid into the county treasury. See also Jones, Illinois Statutes Annotated, Vol. 22, § 110.173, providing that fees in excess of the compensation allowed to probate clerks are paid into the county treasury. See also Burns, Indiana Statutes Annotated, Vol. 10, 1937 supp. § 49.1009, as to the fees of county recorders, providing that 20% of collections shall be retained by the recorder in each county, with added provision that the combination of salary and percentage of fees retained shall not exceed a fixed sum. In Texas *maximum* fees are prescribed instead of straight salaries for certain officials. (See Vernon's Texas Statutes, 1936, Title 61, Fees of Office, Article 383 and following.) In California the fees of county officers are paid into the county treasury and held in what is called a "salary fund" which is used to pay salaries. See Political Code, California, Chapter 10, Salaries & Fees of Officers, 1935 supp. Article LXI, § 4305:

> "For the purpose of paying salaries all fees directed to be paid into the county treasury shall be set apart therein as a separate fund, to be known as the salary fund, to be applied to the payment of salaries. Should, in the opinion of the auditor, the fees to be collected be not sufficient for such purpose, it shall become the duty of the board of supervisors at the time the tax levy is made to estimate such de-

* See Article XV, Section 1, of Md. Const. governing the payment of *excess* fees to the State Treasury.

ficiency and raise it by direct taxation the same as other bonds. The proceeds of the tax levied therefor shall be paid into said salary fund (Amendment affirmed, July 16, 1935, Stats. 1935, p. 1812)."

In Nevada the fees received by the clerk of the Supreme Court are paid into a treasury fund used to pay salaries of judges. See Compiled Laws of Nevada, 1929 (Hillyer), Volume 2, § 2965.

> "The clerk of the Supreme Court shall, on the 1st Monday of each quarter, pay to the State Treasury the moneys received by him for court fees, rendering to said treasurer a brief note of the cases in which the same were received. The money so received by the treasurer shall be placed in the supreme court judges salary fund, and the same shall be used for no other purpose" (Stat. 1919, Subdivision (15)).

The judges of the Court of Common Pleas, Oklahoma County, Okla., are paid out of a fund derived from fees. (Oklahoma Statutes Annot. Titles, 19-20, § 706.)

The imposition of Federal Income Tax on State employees necessarily restricts the power of a State to carry out its governmental functions.

Salaries and fees are the means by which a state obtains the services of its employees and constitute the inducement to enter its service. Any tax imposed by the Federal Government diminishing the net compensation of a state employee necessarily makes the inducement less attractive and directly interferes with or burdens the power of the state to procure employees and (if carried to an extreme) to function at all. The connection of a federal income tax with the ability of a state to function is thus not only direct but in

fact precedes the commencement of a state function by handicapping a state in employing servants in its behalf.

The first tax (1913 Act) consisted of a normal tax of 1% with surtax of 1% on incomes between $20,000 and $50,000. Under the present act the exemptions are less, the normal tax commences at 4%, and the increases in the normal tax and the high surtaxes are too well known to merit further detail. While a tax of 1% might not deter many persons from entering state service, taxes at the present or even higher rates would necessarily make it more difficult for a state to procure proper agents. It could hardly be contended that a tax of 50% was of no importance to prospective state employees and yet the same principle is involved.

The state courts recognize the interference of a state income tax when applied to a federal officer. The Supreme Court of North Carolina in *Purnell* v. *Paige* (1903), 133 N. C. 125) in holding exempt from state income tax the salary of a federal court judge stated as follows:

> "If the State could tax the salaries of Federal officers, or the Federal Government could tax the salaries of State officers, either could destroy the efficiency of the operations of the other government, since each government must act through its officers."

The true theory advanced and adhered to rigidly by our courts is that such income taxes, regardless of the amount of the same are unconstitutional because they interfere with the law of the sovereign (whether Federal or State) fixing the employees' compensation and in effect over-ride the will of the other sovereign, viz., one independent government cannot take away or reduce the compensation fixed by another sovereign state for the compensation of its agents (*Dobbins* v. *Commissioner, The Collector* v. *Day, supra*).

Compare *Evans* v. *Gore* (1919), 253 U. S. 245, and *Ashton* v. *Cameron County District* (1936), 298 U. S. 513 at 531; *Purnell* v. *Paige, supra* (p. 128).

The following court decisions involve officials who were not paid directly by the state or a political subdivision thereof and who were held exempt from Federal income tax:

Brush v. *Commissioner, supra*—(Revenue of City Water Works in part supplied from water charges);

N. Y. ex rel. Rogers v. *Graves, et al.* (1937), 299 U. S. 401—(Compensation of the taxpayer, general counsel for the Panama Railroad paid out of profits of Panama R. R. Co. See opinion N. Y. A. D. 3rd Department, 245 A. D. 452 at 454);

Hoskins v. *Commissioner* (1936), 84 Fed. (2d) 627, C. C. A. 5—(Salary paid out of receipts of cafeteria);

Therrell v. *Commissioner, supra*—(Compensation of bank liquidator paid out of assets of the banks);

Freedman v. *Commissioner, supra*—(Compensation paid out of bank assets);

Montgomery B. Case v. *Commissioner* (1936), 34 B. T. A. #187, Aff'd without opinion C. C. A. 2 under title of *Commissioner* v. *Gerhardt*, F. (2d). (New York Law Journal, Nov. 4, 1937) —(Compensation of officers and employees of Port of New York Authority paid out of a fund derived from tolls and fees collected from the public);

Bettman v. *Warwick* (1901), C. C. A. 6, 108 Fed. 46—(Compensation paid by private individuals employing services of a notary public).

The principle of *The Collector* v. *Day, supra,* though distinguished many times either on the "independent contractor" or "non-governmental function" phase has never been departed from by this court. The decision of the Second Circuit below is the only one of which counsel are aware, where the source of compensation element was held to be the *decisive* element for denial of immunity.

If the power to tax the incomes of state officers and employees exists, it follows incontrovertibly that their compensation can be reduced to the vanishing point and the ability of a state to function thus destroyed (compare *Veazie Bank* v. *Fenno* (1869) 8 Wall 533, 549).

The payment of petitioner's compensation by the statutory appropriation of the assets of the companies in liquidation is in substance the same as a special property tax.

When an insurance company has once been placed in liquidation, the control of its affairs is taken away completely from the officers, directors and stockholders. The Superintendent, pursuant to the statute, is authorized to appropriate money out of the assets in order to pay the expenses of administration including petitioner's salary. The use of these funds must necessarily be pursuant to the state's police power because the consent of the stockholders, who own the corporation is not obtained. If the system is considered in its true light, there would seem to be no distinction between such a levy and a levy in the nature of a special tax that might be easily incorporated in the tax law. See *Therrell* v. *Commissioner, supra,* at page 871:

> "He (the bank liquidator involved) is not chosen by the bank or its creditors, but over their heads. *It is superficial to say that they pay him.* The State

> by its officer does that out of the bank's money, not by the consent of the bank or its creditors but by the State's power, an exaction not unlike the levying of a tax for the purpose." (Italics ours.)

The situation is little different from special assessments on property owners imposed by the state without the consent of such owners with the object of making improvements, constructing a new street, etc. The weakness in the ruling of the Commissioner that the source of compensation *alone* determines immunity is apparent from the fact that it would be possible for the state to pay the employees of the Liquidation Bureau out of state funds in the first instance and then proceed to tax the companies in liquidation under the same formula now adopted in assessing such charges directly against the assets of the companies in liquidation. If the exemption from tax depends upon the Commissioner's theory (upheld by the court below), the exemption would stand or fall, depending upon the particular form of bookkeeping decreed by the statute establishing the liquidating function of the Superintendent and his statutory assistants. (See Political Code Cal. 1935 Supp., *supra*, Nevada Statute, *supra*.)

III.

If the basis for the immunity of State employees from Federal Income Tax be considered to be the presumption that taxation would result in increased salaries then under the same presumption an increase of petitioner's salary would impede and interfere with the State function of effecting economical liquidation of insurers.

As previously set forth (p. 24), counsel do not understand that the exemption from Federal income tax is based on the *presumption* that the imposition of the tax would require increased salaries with resultant depletion of a state's treasury. If, however, such a conception be considered by this court to be the basic reason for immunity from income tax, then a similar presumption as to increase in salary would necessarily apply in petitioner's case. From such point of view an increase in his salary would deplete the assets of the companies in liquidation. The primary purpose of state controlled liquidation is recognized to be economy in the administration of the assets subject to the claims of the interested public (*Matter of Casualty Company of Am., supra; Matter of Knickerbocker Life Ins. Co.*, 1st Dept. N. Y. A. D. 1922, 199 A. D. 503). If the presumption applies, the tax directly operates against and obstructs such economy of administration and imposes a direct burden on the attempt of the state to achieve its purpose. The immunity of a state from federal interference is not confined to interference with its fiscal affairs *per se*, but is a broader protection from any *form* of interference with state sovereignty. (Compare *Ashton* v. *Cameron County*

Dist. (1936) 298 U. S. 513, 531.) It is established that the Federal Government has left the liquidation and winding up of insurance companies to the laws of the several states (*In re Union Guarantee & Mortgage Company, supra*), and under the presumption herein assumed the tax obstructs and restricts the power of the state to protect the public interest in liquidation just as a Federal tax imposed directly on each company applying for a liquidation order would have such effect.

IV.

Petitioner's compensation comes within the terms of the exemption prescribed by Art. 643 of Treasury Reg. 77.

In the concurring opinion of Mr. Justice STONE and Mr. Justice CARDOZO, in *Brush* v. *Commissioner, supra,* they stated that they concurred in the result upon the ground that the petitioner in that case came within the terms of the regulation which for the purpose of the case may be accepted as valid, "its validity not being challenged by counsel for the Government" (p. 374). Even the present regulation (Reg. 94, Art. 116-2) does not preclude the immunity of petitioner's compensation because his salary was received "from the State" (Exhibit Ex. C, R. 12-D). Petitioner's actual pay check came from the New York State Insurance Department and neither the 1932 regulation, which governs petitioner's case, or the recent regulation refer to the method chosen by the State to raise the funds for the compensation of its officers and employees.

Conclusion.

Petitioner's compensation was paid to him for services rendered as an employee of the State of New York engaged in carrying out a proper governmental function and such compensation is not subject to Federal income tax.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed and petitioner's 1932 tax liability be recomputed by excluding said salary from his taxable net income.

Respectfully submitted,

BERNHARD KNOLLENBERG,
JESSE HOYT,
ALFRED C. BENNETT,
JOSEPH W. WYATT,
Attorneys for Petitioner.

November 1937.

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 287

EDWARD McLOUGHLIN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the granting of a writ of certiorari in this case.

The question presented is whether the petitioner's compensation as counsel for the Liquidation Bureau of the New York State Insurance Department is subject to Federal income tax. The decision in the instant case is in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Therrell* v. *Commissioner,* 88 F. (2d) 869, where it was held that the compensation of a liquidator of certain Florida State banks, paid entirely out of funds of the banks, was immune from

Federal taxation. The court below recognized that its decision was in conflict with the decision in the *Therrell* case, saying (89 F. (2d) 699, 702–703):

> Any distinction between the Therrell decision and the case at bar is tenuous but, with all respect, we feel obliged to differ with the decision of the majority.

In the *Therell* case a petition for certiorari on behalf of the Commissioner of Internal Revenue is now pending, No. 128, 1937 Term, wherein it is asserted that the decision in that case is in direct conflict with the decision in the instant case.

The respondent believes that the decision of the Circuit Court of Appeals in the instant case is correct. In view, however, of the conflict of decisions, as well as the importance of the question, which has not been passed on by this Court, the respondent does not oppose the issuance of a writ of certiorari.

Respectfully submitted.

STANLEY REED,
Solicitor General.

AUGUST 1937.

U. S. GOVERNMENT PRINTING OFFICE: 1937

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 13–17) is reported in 34 B. T. A. 963. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 23–30) is reported in 89 F. (2d) 699.

JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered on May 10, 1937. (R. 31.) Petition for certiorari was filed on August 5, 1937

(R. 32), and was granted on October 11, 1937 (R. 32). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner's compensation as counsel for the Liquidation Bureau of the New York State Insurance Department, paid by the Bureau in the year 1932 out of the assets of the companies in liquidation, is subject to Federal income tax.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 34–35.

STATEMENT

The facts, as stipulated (R. 6–11) and as found by the Board of Tax Appeals (R. 13–17), are as follows:

The petitioner is an attorney at law. Prior to 1929 he was associated with a law firm in Brooklyn, New York, and was actively engaged in practice. In 1930 he was appointed by the Superintendent of Insurance of the State of New York to act as counsel in the Liquidation Bureau, a branch of the Insurance Department. He was employed there from the beginning of 1930 until August 2, 1933. During the year 1932 the Liquidation Bureau maintained three offices in New York City. The main office was in the New York State Building at

80 Center Street, where petitioner was employed during 1932, and there were two branch offices, one at 2 Lafayette Street and the other at 111 John Street, New York, New York. The petitioner gave full time required of employees in the Liquidation Bureau, and his hours were from 9 a. m. to 5 p. m., the same as other attaches of that Bureau. (R. 13–14.)

After severing connections with the law firm with which he was connected in 1929 petitioner received no further salary from the firm. He maintained office space in their offices and did a certain amount of personal legal work there, such as the preparation of wills, etc., all of which was accomplished out of his regular hours with the Liquidation Bureau. The members of the firm cooperated with him in handling his personal work and the fees received were divided according to agreement. Petitioner's personal legal fees in 1932 amounted to $1,410 and his office expenses were $570. The greater part of such sum represented fees from matters commenced in 1929, prior to his association with the Insurance Department. None of the personal legal work that he obtained after becoming associated with the Insurance Department was the result, either directly or indirectly, of his connection with that Department. (R. 14.)

The Liquidation Bureau was created in 1909 and is now known as the "Bureau of Liquidations, Conservations and Rehabilitations." This change in designation occurred some time in 1933 and was

made to make the name of the Bureau conform to the description of the title of Article II, Chapter 191, of the Insurance Laws of the State of New York, which went into effect on March 15, 1932. It will be hereinafter referred to as the Bureau. The Bureau was in the year 1932 and now is under the charge of a Special Deputy Superintendent of Insurance. The Special Deputy Superintendent is a Civil Service employee of the State of New York, and his salary is paid directly by the State. The Bureau also had in 1932 three assistant Special Deputy Superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants. At the beginning of 1932 the Bureau had approximately 100 employees and at the end of 1932 the number had been increased to approximately 400, none of whom, with the exception of the Special Deputy Superintendent in charge, were Civil Service employees. The number of employees varied according to the number of insurance companies under the Bureau's jurisdiction. (R. 14.)

The general functions and duties of the Bureau are as follows: Under the Insurance Laws of the State of New York the Superintendent of Insurance of that State may, on certain grounds, apply to the judicial authorities of the State for an order directing him to take over the assets of insurers doing business, or in process of organization for the purpose of doing business in the State, for the purpose of liquidating, rehabilitating, or conserv-

ing the business of such insurers. Upon an order directing rehabilitation, liquidation, or conservation being granted, all of the work necessary to accomplish any of these results is performed by the Bureau. When an order is obtained directing the liquidation of an insurance company, its charter is dissolved and no new business is transacted. The work of liquidation consists of adjudicating the claims of the creditors of the company, selling the real estate and the other assets, and attempting to collect premiums due. After all of the assets of a company have been realized upon, dividends are distributed *pro rata* to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company. When an order is obtained directing the rehabilitation of an insurance company, the Bureau actively operates it (but conducts no new business) and takes steps to remove the causes and conditions which made such proceeding necessary in an effort to bring about its rehabilitation and place the company in a sound financial condition. If the Bureau succeeds in rehabilitating the insurer, the assets are turned back to it and it resumes operations under its own direction. (R. 15.)

If and when it is determined that further efforts to rehabilitate a company will be futile, the Superintendent of Insurance may apply for an order of liquidation. No rehabilitation work was done by the petitioner or the Bureau in 1932. Although the Superintendent of Insurance was authorized to

apply for rehabilitation orders, no such order was applied for until the year 1933. Upon taking charge of a company for liquidation purposes, certain of the staff of the company, such as underwriters and the so-called "production staff", would be dismissed. The key employees would be retained, and the remainder dismissed as soon as practicable. It was the policy of the Bureau to centralize the liquidation work as much as possible in one office. The procedure would necessarily vary according to the size of the companies placed in liquidation, etc. In the case of a very large company its affairs could not be transferred to another office for a long period of time. At the beginning of 1932 the Bureau was liquidating 39 insurance companies; at the end of 1932 it was liquidating 11 companies. (R. 15–16.)

In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record. He devoted over 90% of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office. The balance of his time was devoted to legal problems of the Bureau as a whole, such as the drafting of a new Article XI of the Insurance Law. (R. 16.)

In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. The expenses of the Bureau, including

all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account". Simultaneously with the drawing of checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn from the Wash Account to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet the petitioner's compensation, and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having charge of all the assets of such company) was in a position to draw checks on the account. (R. 16.)

Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted to them by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted to affairs of one particular company would be charged against such company. Petitioner's time devoted to the general legal problems of the Department would be prorated among the various companies under a

formula designed to charge general administration expenses of the Department to the companies in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies. (R. 16–17.)

Petitioner's compensation during 1932 was paid bimonthly by check, but was computed on an annual basis. Petitioner did not receive any additional compensation from the Insurance Department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the Superintendent and the compensation did not vary in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the Superintendent of Insurance. (R. 17.)

In the budget of the Superintendent of Insurance there appeared an item called the "reserve fund" for the use of the Superintendent in liquidating insurance companies whose assets were not sufficient to pay the cost of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932, and 1933, the amount of the reserve fund was $5,000. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund. (R. 17.)

The petitioner in his income tax return for the taxable year 1932 reported a salary of $5,125 as

counsel for the Liquidation Bureau of the New York State Insurance Department, but claimed that it was exempt from Federal income tax (R. 23). The respondent, holding such salary not to be immune from Federal income tax, determined the deficiency here in question in the amount of $224.09 (R. 3). The Board of Tax Appeals and the Circuit Court of Appeals for the Second Circuit sustained the respondent's determination. (R. 18, 31.)

SUMMARY OF ARGUMENT

The only question in this case is whether the Federal Government may constitutionally tax petitioner's compensation as counsel for the Liquidation Bureau of the New York State Insurance Department. We submit that the decision of the court below must be affirmed because (1) petitioner's services were not rendered in connection with an essential governmental function, and (2) his compensation was paid from private rather than state funds. Our argument in this connection is fully developed in Points I and II (pp. 11–35) in *Helvering* v. *Therrell*, No. 128, October Term, 1937.

I

The regulation of insurance companies is an essential governmental function. Their operation is not. The liquidation of an insolvent company is not a state-wide regulatory activity, but merely the attempt economically to liquidate the assets

of a particular company for the sole benefit of those interested in its affairs.

II

The petitioner's compensation was paid out of the funds of the insolvent insurance companies in connection with the affairs of which he was engaged. (New York Insurance Law, Sec. 414, *infra.*) Since he is paid from private rather than State funds, a tax on his compensation contains no threat to the independence of the State government. Petitioner's contention that the immunity of the government employee is not based on a fear of affecting the public treasury leaves the doctrine without any reason to support its result. The only other reason which has been advanced by this Court, that a tax would reduce the compensation fixed by the other government, has been rejected in the case of the independent contractor. Our argument does not go to the point of taxing the fees by which certain officers are paid, since these fees, in distinction to the assets of the insolvent insurance companies, are the revenues of the State. Nor does our argument turn upon a question of bookkeeping: however the State might have arranged for petitioner's compensation, the fact remains that it did not choose to pay it out of State funds.

ARGUMENT

I

THE SERVICES OF THE PETITIONER WERE NOT IN CONNECTION WITH AN ESSENTIAL GOVERNMENTAL FUNCTION

The court below found it unnecessary to pass upon the nature of the power exercised by the State of New York in the liquidation of insolvent insurance companies and stated merely that "it may well be" that the petitioner's activities, like those of a receiver, were essential (R. 26). The respondent submits that in the liquidation of insolvent insurance companies the State of New York was not engaged in the exercise of an essential governmental function. In support of this view, the respondent, in the interests of brevity, adopts and incorporates herein by reference the argument presented under Point I (pp. 11–21) in the brief filed on behalf of the petitioner in *Helvering* v. *Therrell,* No. 128, October Term, 1937. The remainder of this argument will be directed toward considerations particularly applicable to the liquidation of insurance companies by the State of New York and to the arguments advanced by petitioner.

Here, as in the *Therrell* case (Govt. Br. 12), we readily concede that the *regulation* of insurance companies is an essential governmental function.

We have, therefore, no quarrel with petitioner (Br. 10–12) on this score. Similarly, petitioner appears to concede, in his distinction of the "proprietary" cases (Br. 12), that the *operation* of an insurance company would not be an essential governmental function. So here, as in the *Therrell* case, the issue is narrowed to whether or not the liquidation of insolvent insurance companies is more akin to their operation or to their regulation.

Petitioner demonstrates (Br. 13–15) that the State has a legitimate and important interest in the liquidation of insolvent insurance companies. With this we are in complete accord. The obvious purpose of the statutes under which the Liquidation Bureau functioned was to substitute an economical liquidation of insolvent insurance companies by the State in place of the receiverships which had in the past proved extravagant and wasteful. See *In re Russian Reinsurance Co. of Petrograd, Russia,* 223 A. D. 378; *Van Tuyl* v. *Scharmann,* 208 N. Y. 53, 63. The State, of course, had the power to levy taxes for the purpose of maintaining such regulation. *In re Bond & Mortgage Guarantee Co.,* 283 N. Y. S. 623, 626. This, however, is far from establishing that the activity was an essential governmental function, such that federal taxation of the salaries of those engaged in the liquidation threatens the independence of the State government. See *Helvering* v. *Powers,* 293 U. S. 214, 225. New York State in the years prior to 1909 was a sovereign and independent state

without any form of administrative liquidation of insolvent insurance companies. The legislation which established the Liquidation Bureau was a notable recognition of the responsibility of the State in providing an efficient means to salvage the investments of policyholders and creditors. But the very date of its enactment shows that its abandonment would not mean that "in a very real sense" the State "itself would then disappear." *Brush* v. *Commissioner*, 300 U. S. 352, 371.

This becomes plain when it is considered that the Liquidation Bureau does not operate to enforce State-wide regulatory measures, nor to prescribe rules for the safe conduct of the insurance business generally. It serves only to liquidate efficiently the assets of a particular insurer, in order to make as large a return as possible to the policyholders, creditors and stockholders of that particular company (New York Insurance Law, Sec. 426, *infra*). The Superintendent is vested by operation of law with title to the property and the contracts of the insurer; the order of liquidation must direct him to "deal with the property and business of such insurer" in his own name or that of the insurer (Sec. 404, *infra*). The expenses of the liquidation are paid out of the funds of the insurer (Sec. 414, *infra*). The Superintendent borrows any necessary funds not through the State but on pledge of the assets of the insurer (Sec. 421a, *infra*).

Thus, the status of the Superintendent when functioning as the liquidator or rehabilitator of

insolvent insurance companies is essentially that of a receiver.[1] *Conway* v. *North Side Lumber Co.*, 252 N. Y. S. 476; *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420 (C. C. A. 2d); *Tolfree* v. *New York Title & Mortgage Co.*, 72 F. (2d) 702 (C. C. A. 2d). His liquidation activities, as those of any receiver, are directed toward the benefit of the particular persons interested in a particular business enterprise. The success or failure of the liquidation has no appreciable effect upon the conduct of solvent insurers, nor on the citizens of the State generally. In liquidation, as in operation, the business may be "affected with a public interest." But in neither case is the pecuniary success of the activity a matter of concern to any but the interested parties. And there is no goal other than the pecuniary one. Liquidation, as operation, remains essentially a private enterprise conducted for profit (or minimization of loss).[2] It is not a

[1] As such, the corporate assets of the insolvent insurance companies are in his hands in *custodia legis* and subject to judicial control except in matters as to which the statute vests the Superintendent with discretionary powers. *Matter of People (Tit. & Mtge. Guar. Co.)*, 264 N. Y. 69.

[2] It is true that the enterprise is a favored one. Its affairs are subject to judicial supervision. It is subject to suit only in the court which has jurisdiction and is immune to subsequent liens or execution of judgment (Sec. 410, *infra*). The Superintendent may subpoena and examine persons and records (Sec. 415, *infra*). It is exempt from filing and recording fees (Sec. 416, *infra*) and its deposits are entitled to priority (Sec. 417, *infra*). But it remains an activity on behalf of those interested in a particular insurer, and is not governmental regulation.

matter of *governmental* concern of a magnitude such that it is essential to the independence of the State.

It may be suggested that an orderly liquidation is merely an aspect of regulation. We do not deny its close relationship. But this relationship is precisely that which obtains between the operation and the regulation of insurance companies. We know of no reason for State liquidation—whether it be maintenance of confidence in insurance companies generally, or aiding the policyholders and creditors of a given insurer—which is not fully applicable to State operation of going insurers. And there is no contention that a state operated insurance company would be an essential governmental function such as to be exempt from federal taxation. See *State of North Dakota* v. *Olson,* 33 F. (2d) 848 (C. C. A. 8th), appeal dismissed for want of jurisdiction, 280 U. S. 528; 2 Cooley on Taxation (4th ed.), Sec. 639.

II

A TAX ON COMPENSATION PAID FROM PRIVATE FUNDS CONTAINS NO THREAT TO THE DUAL SYSTEM OF GOVERNMENT

The respondent adopts and incorporates herein by reference the argument made in the petitioner's brief under Point II (pp. 21–35) in *Helvering* v. *Therrell,* No. 128, October Term, 1937, in support of this proposition. In this brief we shall indicate the matters relevant to the compensation paid

those engaged in liquidating New York insurance companies and discuss certain contentions of the petitioner.

1. Section 414 of the New York Insurance Law, *infra,* provides that "the compensation of such special deputy superintendents, counsel, clerks and assistants, and all expenses of conducting any proceeding under this article shall be fixed by the superintendent, subject to the approval of the court, and shall, on certificate of the superintendent, be paid out of the funds or assets of such insurer." Petitioner's compensation was prorated among the insolvent companies in proportion to the time he spent on the affairs of each, and the 10 per cent of his time devoted to general problems of the Department was prorated among all the insolvent companies by formula. Payments were made out of the "Wash Account", which in turn was credited with drafts in appropriate amounts upon the accounts of the particular insolvent companies in question. (R. 16–17.)

Thus it is evident that petitioner, as the respondent in the *Therrell* case, is paid from private rather than State funds. A federal tax on his compensation accordingly contains no possibility of endangering our dual system. Such was the decision of this Court in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 174.

2. Petitioner argues (Br. 22–24) that the effect of the federal tax upon the state treasury is material only in connection with independent contractors

and with transactions but indirectly related to the state function. To buttress this view he renounces as "purely guess work" any presumption that income taxes upon government employees, which "are paid out of the pockets of the individual taxpayers", are reflected in the state treasury (Br. 24, 23).

In the first place, petitioner's position makes the exemption of the salaries of officers and employees a matter more of fiat than of reason. The government employee is a private person. He pays property taxes and excise taxes. He is, however, exempted from paying an income tax upon his government salary. We think it evident that the Circuit Court of Appeals for the Second Circuit was right in saying that there can be no rational reason for this single immunity other than the belief that this tax will be reflected in the state treasury (*Harman* v. *Helvering,* 90 F. (2d) 622, 623). If it were thought that an income tax on the salary of a government employee could not affect the sovereign there would be no reason for the exemption. We submit that petitioner cannot at once claim the protection of the employee's tax immunity and reject the reason upon which it is based.

In the second place, petitioner mistakes the opinions of this Court in the cases which have declared exempt the salaries of government employees. So far as we can determine there have been only four cases in which this question has been decided. In *Brush* v. *Commissioner,* 300 U. S. 352,

and *New York ex rel. Rogers* v. *Graves,* 299 U. S. 401, the Court did not spell out the reason for the employee's immunity, but relied upon earlier decisions. In *Collector* v. *Day,* 11 Wall. 113, the Court, apart from general expressions to the effect that an instrumentality of government could not be taxed, relied upon *Dobbins* v. *Commissioners,* 16 Pet. 435, and devoted the bulk of its opinion to the proposition that the immunity of federal instrumentalities was equally applicable to state instrumentalities. This leaves *Dobbins* v. *Commissioners* as the only case in which this Court has ever sought as a ground of decision to explain the immunity from income tax which is granted to government employees.[3] The basis of this decision was twofold. The Court first argued that the Congress might have to increase the compensation of the captain in consequence of the tax. It said (16 Pet. at 448):

> Is not compensation the means by which his services are procured and retained? It is true, it becomes his, when he has earned it. If it can be taxed by a state, as compensation, will not congress have to graduate its amount with reference to its reduction by

[3] The case, strictly, is not one of an income tax. The Commissioners of Erie County imposed a property tax of $10.75 on the *office* of a captain of a United States revenue cutter, which was valued at $500 (16 Pet. at 444). But the assessors were directed "to rate all offices and posts of profit * * * having a due regard to the profits arising therefrom." (16 Pet. at 445.)

> the tax? Could congress use an uncontrolled discretion in fixing the amount of compensation, as it would do, without the interference of such a tax? * * *

The Court then advanced as a second ground the fact that the tax would diminish the compensation which had been fixed by Congress. It said (pp. 449–450):

> The compensation of an officer of the United States is fixed by a law made by congress. * * * Does not a tax, then, by a state upon the office, diminishing the recompense, conflict with the law of the United States, which secures it to the officer in its entireness?

Of the two grounds of decision in *Dobbins* v. *Commissioners,* the second has, we believe, indisputably been rejected by this Court. A tax on the net income of an independent contractor diminishes the compensation fixed by the government with whom he contracts. Yet it is settled that such a tax is valid. *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514. So, too, may the gross receipts of the contractor be diminished by the amount of a state gross receipts tax. *James* v. *Dravo Contracting Co.,* No. 3, October Term, 1937; cf. *Alward* v. *Johnson,* 282 U. S. 509; *Liggett & Myers Co.* v. *United States,* 299 U. S. 383; *Fidelity & Deposit Co.* v. *Pennsylvania,* 240 U. S. 319. And none has ever supposed, when the state fixes the rates of a public utility so as to give a fair return upon its

property, that the utility acquires an immunity to federal taxation.

This leaves the first ground of the decision in *Dobbins* v. *Commissioners* as the only reason, which has been advanced and not subsequently rejected, for the immunity of the government employee from taxation by the other sovereign. This reason is the fear that the employing government, in paying the compensation, would "have to graduate its amount with reference to its reduction by the tax." Coupled with the belief that the power to tax is the power to destroy, it has resulted in the tax immunity of employees paid out of the government funds. But its reasoning is obviously inapplicable to employees paid out of private funds. And, as this Court has frequently pointed out, the doctrine of tax immunity is limited by its reason. *National Bank* v. *Commonwealth,* 9 Wall. 353, 362; *Board of Trustees* v. *United States,* 289 U. S. 48, 59; *Helvering* v. *Powers,* 293 U. S. 214, 224–225. *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325, 328; *Metcalf & Eddy* v. *Mitchell, supra,* 523.

3. Petitioner states (Br. 25) that our position "would create a wholly unwarranted distinction between state paid salaries and the fee system." He then argues (Br. 25–28) that many state officers are paid by fees and should share the immunity of those paid by salaries. We agree that the officer paid by fees should have the immunity of those

paid a salary. We deny that our position requires a distinction. As pointed out in our brief in the *Therrell* case (pp. 31–32), the fees are a part of the State revenues and the officer's compensation is paid by the State just as fully as though he transmitted the entire amount to the State treasury and received from the State an amount corresponding to the designated amount or percentage. But in petitioner's case he is paid not out of state revenues but from private funds. Whether he receives a greater or smaller amount in no manner affects the state revenues, but is of interest only to the policyholders, creditors and stockholders of the company with whose affairs he is engaged.

4. Petitioner suggests (Br. 32) that our argument makes tax exemption turn upon what is merely a matter of bookkeeping. But it is obviously more than a matter of form whether or not the State or the insolvent company pays the expenses of liquidation. The New York Insurance Law itself makes the distinction, by requiring, in Section 7, that the actual expenses of examination be paid into the Treasury by solvent insurers, while the expenses of liquidation are paid directly out of the funds of the insolvent company (Sec. 414, *infra*). This points the obvious difference between state and private payment. To take a simple example, the state might require the adjoining owner to improve the road in front of his property; alternatively, the same result could be

reached if the state were itself to improve the road and levy a special assessment on adjoining property owners to recoup the cost. Yet none doubts but that the tax immunity which is supposed to attach to the compensation of the laborer hired by the state would not remain if he were hired instead by the property owner to do the same work. The mere fact that the state might, if it chose, make the payments itself does not carry the immunity of such payments over into the situation where the state is not in fact making the payments.

It should further be noted that even if this basic distinction were not present, and if tax immunity did in fact turn on bookkeeping alone, our argument would not thereby be disproved. Many "close distinctions" have been observed "in this difficult field." *James* v. *Dravo Contracting Co. supra* (pamph. pp. 11, 13). The broad doctrine that government employees and officers are tax exempt on their compensation could not otherwise be applied "without unduly limiting the taxing power which is equally essential to both nation and state under our dual system." *James* v. *Dravo Contracting Co., supra* (pamph. p. 11).

5. Finally, the petitioner's contention that the imposition of a Federal income tax on the petitioner's compensation would necessarily restrict the State of New York in the performance of its functions of liquidating insolvent insurance companies (Br. 29–31, 33–34) is predicated on the assertion that if such tax may be constitutionally im-

posed the petitioner's "compensation can be reduced to the vanishing point" and the ability of the State of New York to function thus be destroyed. The argument ignores the nature of the tax, which, unlike that in *Veazie Bank* v. *Fenno*, 8 Wall. 533, is non-discriminatory in nature.

CONCLUSION

The tax in question is not forbidden by the implication of the Constitution, in that it is imposed (1) with respect to an activity which is not an essential governmental function, and (2) on compensation derived from private rather than state funds. Either of these considerations is sufficient to support the determination of the Commissioner and the decisions of the Board of Tax Appeals and the Circuit Court of Appeals. The judgment of the court below should, therefore, be affirmed.

Respectfully submitted.

STANLEY REED,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
BERRYMAN GREEN,
Special Assistants to the Attorney General.
WARNER W. GARDNER,
Special Attorney.

DECEMBER, 1937.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, * * *.

Treasury Regulations 77:

ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable.

* * * * *

New York Insurance Law (McKinney's Consolidated Statutes, Book 27):

SEC. 401. *Grounds for rehabilitation of domestic insurer.*—The superintendent may

apply under this article for an order directing him to rehabilitate a domestic insurer upon any one or more of the following grounds: that such insurer (a) is insolvent; or (b) has refused to submit its books, papers, accounts or affairs to the reasonable inspection of the superintendent or his deputy or examiner; or (c) has neglected or refused to observe an order of the superintendent to make good within the time prescribed by law any deficiency, whenever its capital, if it be a stock corporation, or its reserve, if it be a mutual corporation, shall have become impaired; or (b) has, by contract of reinsurance or otherwise, transferred or attempted to transfer substantially its entire property or business, or entered into any transaction the effect of which is to merge substantially its entire property or business in the property or business of any other corporation, association, society, order, partnership or individual, without having first obtained the written approval of the superintendent; or (e) is found, after an examination, to be in such condition that its further transaction of business will be hazardous to its policyholders, or to its creditors, or to the public; or (f) has wilfully violated its charter or any law of the state; or (g) has an officer who has refused to be examined under oath, touching its affairs; or (h) if organized under article five-a, six, seven, eight, ten-a or ten-b of this chapter is found to be in such condition, after examination, that it could not meet the requirements for incorporation and authorization specified in such articles respectively; or (i) has ceased to transact the business of insurance for a period of one

year; or (j) has commenced voluntary liquidation or dissolution, or attempts to commence or prosecute any action or proceeding to liquidate its business or affairs, or to dissolve its corporate charter, or to procure the appointment of a receiver, custodian, or sequestrator under any law except this article; or (k) has been the subject of an application for the appointment of a receiver, custodian or sequestrator of the insurer or its property, or if a receiver, custodian or sequestrator, is appointed by a federal court or such appointment is imminent; or (l) has consented through a majority of its directors, stockholders, or members; or (m) has not organized and obtained a certificate authorizing it to commence the transaction of its business within one year from the date of its incorporation as provided for in section sixty-six-a of this chapter.

SEC. 402. *Order of rehabilitation; termination.*—1. An order to rehabilitate a domestic insurer shall direct the superintendent and/or his successors in office forthwith to take possession of the property of such insurer and to conduct the business thereof, and/or to take such steps toward the removal of the causes and conditions which have made such proceeding necessary as the court shall direct.

2. At any time the superintendent shall deem that further efforts to rehabilitate such insurer would be futile, he may apply to the court under this article for an order of liquidation.

3. The superintendent, or any interested person upon due notice to the superintendent, at any time, may apply for an order terminating this proceeding and permitting

such insurer to resume possession of its property and the conduct of its business, but no such order shall be granted except when, after a full hearing, the court shall determine that the purposes of the proceeding have been fully accomplished.

SEC. 403. *Grounds for liquidation of domestic insurer.*—The superintendent may apply, under this article, for an order, directing him to liquidate the business of a domestic insurer upon any one or more of the grounds specified in section four hundred and one of this chapter, regardless of whether or not there has been a prior order directing him to rehabilitate such insurer.

SEC. 404. *Order of liquidation; rights and liabilities.*—1. An order to liquidate the business of a domestic insurer shall direct the superintendent and/or his successors in office forthwith to take possession of the property of such insurer and to liquidate the business of the same and to deal with the property and business of such insurer in their own names as superintendents or in the name of the insurer as the court or justice before whom such order is returnable may direct, and to give notice to all creditors who may have claims against such insurers to present the same.

2. The superintendent and/or his successors shall be vested by operation of law with the title to all of the property, contracts, and rights of action of such insurer as of the date of the order so directing them to liquidate. The filing or recording of such order in any record office of the state shall impart the same notice that a deed, bill of sale, or other evidence of title duly filed or recorded by such insurer would have imparted. The rights and liabilities of any such insurer and of its creditors, policyholders, stockholders,

members, and/or all other persons interested in its estate shall, unless otherwise directed by the court, be fixed as of the date of the entry of the order directing the liquidation of such insurer in the office of the clerk of the county where such insurer had its principal office for the transaction of business upon the date of the institution of proceedings under this article. Provided, however, that the right of claimants holding contingent claims on said date to share in an insolvent estate shall be determined by section four hundred and twenty-five of this chapter.

* * * * *

SEC. 407. *Grounds for dissolution of domestic insurer.* — The superintendent may apply under this article for an order dissolving the corporate existence of a domestic insurer; (a) upon his application for an order of liquidation of the business of such insurer, or at any time after such an order has been granted; or (b) upon the grounds specified in section four hundred and one, subdivision (m) of this chapter, regardless of whether an order of liquidation is sought or has been obtained.

SEC. 408. *Commencement of a proceeding.* — The superintendent, the attorney-general representing him, shall commence any proceeding under this article by an application to the supreme court, or to any justice thereof, in the judicial district in which the principal office of the insurer involved is located, for an order directing such insurer to show cause why the superintendent should not have the relief prayed for. On the return of such order to show cause, and after a full hearing, which shall be held by the court or justice without delay, such court, or justice shall either deny the application or

grant the same together with such other relief as the nature of the case and the interests of policyholders, creditors, stockholders, members, and/or the public may require.

* * * * * *

SEC. 410. *Injunctions.*—1. Upon an application by the superintendent for an order to show cause under this article, or at any time thereafter, the court in which such order is made, or any justice thereof may, without notice, issue an injunction restraining the insurer named in the order, its officers, directors, stockholders, members, trustees, agents, servants, employees, policyholders, attorneys, managers, and/or all other persons from the transaction of its business or the waste or disposition of its property until the further order of the court.

2. Such court or justice may at any time during a proceeding under this article issue such other injunctions or orders as may be deemed necessary to prevent interference with the superintendent or the proceeding, or waste of the assets of the insurer, or the prosecution of any actions, or the obtaining of preferences, judgments, attachments or other liens, or the making of any levy against the corporation or against its assets or any part thereof.

SEC. 411. *Annual report.*—The superintendent shall transmit to the legislature in his annual report, the names of all insurers proceeded against under this article together with such facts as shall acquaint the policyholders, creditors, stockholders, and/or the public with all proceedings. To that end the special deputy superintendent in charge of any such insurer shall file annually with the superintendent a report of the affairs of such insurer.

SEC. 412. *Removal of proceedings to Albany.*—At any time after the commencement of a proceeding under this article, the superintendent may remove the principal office of the insurer to the county of Albany. In the event of such removal, the court shall, upon the application of the superintendent, direct the clerk of the county wherein such proceeding was commenced, to transmit all of the papers filed therein with such clerk to the clerk of the county of Albany and the proceeding shall thereafter be conducted in the same manner as though it had been commenced in the county of Albany.

SEC. 413. *Rules.*—For the purpose of this article, the superintendent shall have the power, subject to the approval of the court, to make and prescribe such rules and regulations as to him shall seem proper.

SEC. 414. *Appointment of deputies; employment of assistants; payment of salaries and expenses.*—1. For the purposes of this article the superintendent shall have power to appoint under his hand and official seal, one or more special deputy superintendents of insurance, as his agent or agents, and to employ such counsel, clerks, and assistants as may by him be deemed necessary, and to give each of such persons such powers to assist him as he may consider wise.

2. The compensation of such special deputy superintendents, counsel, clerks, and assistants, and all expenses of conducting any proceeding under this article shall be fixed by the superintendent, subject to the approval of the court, and shall, on certificate of the superintendent, be paid out of the funds or assets of such insurer.

SEC. 415. *Examinations; misdemeanors thereon; immunity; penalty for refusal to be examined.*—1. At any time during the

progress of any proceeding taken under this article, the superintendent shall have power either personally or by his deputies, including his special deputy superintendents or examiners to subpoena witnesses, to compel their attendance, to administer an oath, and to examine any person under oath, before him, or before a deputy or examiner duly designated for such purpose, and in connection therewith to require the production of any books or papers relevant to the inquiry. If a person subpoenaed to attend such inquiry fails to obey the command of a subpoena without reasonable excuse, or if a person in attendance upon such inquiry, shall, without reasonable cause, refuse to be sworn, or to be examined, or to answer a question, or to produce a book or paper when ordered to do so by the officer duly conducting such inquiry, or if a corporation, association, partnership, or individual fails to perform any act required hereunder to be performed, he shall be guilty of a misdemeanor, and, in addition thereto, compliance with the above provisions may be imposed pursuant to section four hundred and six of the civil practice act. Any officer participating in such inquiry and any person examined as a witness upon such inquiry who shall disclose to any person, other than the superintendent, the name of any witness examined or any other information obtained upon such inquiry, except as directed by the superintendent, shall be guilty of a misdemeanor.

2. If any person shall ask to be excused from testifying or producing any book or paper or other document before the superintendent or before any person duly designated by him to conduct any such investigation upon the ground or for the reason that the testimony or evidence, documentary or

otherwise, required of him may tend to incriminate him or degrade him or to subject him to a penalty or forfeiture, and shall notwithstanding be directed by the superintendent or by the person duly designated by the superintendent to conduct any such inquiry to testify or to produce such book, paper, or document, he must none the less comply with such direction but in such event he shall not thereafter be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, pursuant thereto and no testimony so given or produced shall be received against him upon any criminal action, suit or proceeding, investigation, inquisition, or inquiry. Provided, however, no person so testifying shall be exempt from prosecution or punishment for any perjury or other false statement committed or made by him in his testimony given as herein provided for.

3. Any individual, co-partnership, unincorporated association, or corporation which refuses to permit examination or investigation in accordance with the terms of this section shall forfeit to the people of the state the sum of two hundred dollars for every day, after the date of such refusal, that such individual, co-partnership, unincorporated association, or corporation continues to refuse to permit such examination or investigation.

SEC. 416. *Exemption from filing fees.*— The superintendent shall not be required to pay any fee to any public officer for filing, recording, or in any manner authenticating any paper or instrument relating to any proceeding under this article.

SEC. 417. *Deposit of monies collected; preference.*—The monies collected by the superintendent in a proceeding under this article shall be, from time to time, deposited in one or more state or national banks, savings banks, or trust companies, and in the case of the insolvency or voluntary or involuntary liquidation of the depositary, such deposits shall be entitled to priority of payment on an equality with any other priority given by the banking law; or such moneys may be deposited in a national bank or trust company as a trust fund.

* * * * *

SEC. 421. *Sale or other disposition of assets and compromise of claims.*—The superintendent may, subject to the approval of the court, (a) sell or otherwise dispose of the real and personal property, or any part thereof, of an insurer against whom a proceeding has been brought under this article and (b) sell or compound all doubtful or uncollectible debts or claims owed by or owing to such insurer including claims based upon an assessment levied against a member of a mutual insurer, provided that whenever the amount of any such debt or claim owed by or owing to such insurer does not exceed two hundred dollars, the superintendent may compromise or compound the same upon such terms as he may deem for the best interests of said insurer without obtaining the approval of the court.

SEC. 421-a. *Borrowing on the pledge of assets.*—For the purpose of facilitating the rehabilitation, liquidation, conservation, or dissolution provided for by this article the superintendent may, subject to the approval of the court, borrow money and execute, acknowledge, and deliver notes or other evidences of indebtedness therefor and se-

cure the repayment of the same by the mortgage, pledge, assignment, transfer in trust, or hypothecation of any or all of the property whether real, personal, or mixed of an insurer against whom a proceeding has been brought under this article and the superintendent, subject to the approval of the court, shall have power to take any and all other action necessary and proper to consummate any such loans and to provide for the repayment thereof. The superintendent shall be under no obligation personally or in his official capacity as superintendent of insurance to repay any loan made pursuant to this section.

* * * * *

SEC. 426. *Distribution of assets; priorities; unclaimed dividends.*—1. Any time after the last day fixed for the filing of proofs of claim in the liquidation of a domestic insurer, the court may, upon the application of the superintendent, authorize him to declare out of the funds remaining in his hands after the payment of expenses one or more dividends. Such order shall specify what claims, if any, are entitled to priority of payment and shall direct the manner in which dividends shall be paid. (a) Where there has been no adjudication of insolvency, the superintendent shall pay all allowed claims in full and shall distribute the balance of the assets remaining in his hands in accordance with the direction of the court. The superintendent shall not be chargeable for any assets so distributed to any claimant who has failed to file a proper proof of claim before such distribution has been made. (b) Where there has been an adjudication of insolvency pursuant to section four hundred and twenty-four of this chapter and there is a surplus, after a re-

serve has been set up for the payment in full of all claims which have been duly filed prior to the last day fixed for the filing thereof, when and if such claims shall have been allowed, the solvency of such insurer shall be re-examined and if such insurer is then found to be clearly solvent, the surplus shall be distributed as though no order under section four hundred and twenty-four of this chapter had been made. If, however, the solvency of such insurer still is not clear, the court shall set a new date for the filing of claims under said section four hundred and twenty-four. A second distribution shall be made upon the expiration of that period after the manner of the first distribution including the disposition of any further surplus, which procedure shall be repeated as often as may be necessary.

2. Dividends remaining unclaimed or unpaid in the hands of the superintendent for six months after the final order of distribution may be by him deposited in one or more state or national banks, trust companies, or savings banks to the credit of the superintendent of insurance, whosoever he may be, in trust for the person entitled thereto. All such deposits shall be entitled to priority of payment in case of the insolvency or voluntary or involuntary liquidation of the depository on an equality with any other priority given by the banking law.

Prior to March 15, 1932, liquidation proceedings were undertaken by the Superintendent under the authority of Laws of 1909, ch. 300, as amended (Section 63 of Insurance Law). Except that there was no provision for rehabilitation proceedings, the procedure was the substantial equivalent of the more elaborate system enacted in 1932 (L. 1932 ch. 191).

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 287

EDWARD McLOUGHLIN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Brief of the Attorney General of the State of New York, as *Amicus Curiae*, in Support of the Contention of Petitioner

JOHN J. BENNETT, JR.,
Attorney General of the State of New York.

Of Counsel:

HENRY EPSTEIN,
Solicitor General,

JOHN F. X. McGOHEY,
COLIN McLENNAN,
JOHN C. CRARY,
Assistant Attorneys General.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM—1937

No. 287

EDWARD McLOUGHLIN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF THE ATTORNEY GENERAL OF THE STATE OF NEW YORK, AS *AMICUS CURIAE*, IN SUPPORT OF THE CONTENTION OF PETITIONER

Statement

In view of the importance of the principles involved herein, the Attorney General of the State of New York files this brief as *amicus curiae.*

Constitutional Question Involved

May the Federal Government impose a tax on the compensation of employees of the State of New York regu-

larly and continuously employed in the Insurance Department of the State of New York in the liquidation of insolvent insurance companies pursuant to the laws of the State?

The facts upon which the case was decided by the Court below are sufficiently set forth in the brief of the petitioner and need not be repeated here. They may be summarized by saying that the petitioner was an employee of the State of New York engaged in carrying on a governmental function and for which he was paid an annual salary.

It is clear from a careful reading of the opinion of Augustus N. Hand, J., in the Court below, that the order of the Board of Tax Appeals was affirmed upon the ground that the tax "imposes no real burden upon, or impediment to a normal exercise of sovereign power." The opinion sums up the class of cases or situations where exemption from tax has been disallowed. Judge Hand states that there are two such situations:

> "(1) Where a State has departed from its usual governmental functions and engaged in business enterprises for the public benefit, *Helvering* v. *Powers,* 293 U. S. 214; *Ohio* v. *Helvering,* 292 U. S. 360; *South Carolina* v. *United States,* 199 U. S. 437;
>
> (2) Where persons subjected to taxation are neither officers nor regular employees of the State, but are so-called independent contractors, *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514."

With such a statement of the law (and with it we entirely agree), it is difficult to understand the conclusion arrived at by the learned Court below. Clearly, the State

of New York has not "departed from its usual governmental functions" in supervising the great business of insurance for the protection and benefit of its people, and it is impossible to bring the petitioner herein within the second category because, on the conceded facts, the petitioner was a regular employee of the State, paid on an annual basis; he most certainly was not an "independent contractor".

Since, therefore, the petitioner was (1) a regular employee of the State of New York, and (2) engaged in the carrying on of a usual governmental function, the order must be reversed under the authority of *Brush* v. *Commissioner,* 300 U. S. 352, unless the mere fact that the petitioner was paid his salary by the State out of funds which the State itself had secured out of the assets of insurance companies which it was at the time liquidating, requires a different determination. We submit that the source from which the State derives the money from which it pays its employees is wholly irrelevant, whether it be from taxation, assessment, fee, fine, penalty or escheat.

The contention of the Government here and of the Court below that the petitioner was paid from private sources does not wholly accord with the uncontroverted facts of record.

The facts with respect to the payment of petitioner's salary are set forth in the record as follows:

> "8. In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. *The expenses of the Bureau, including all salaries, were paid by checks drawn on this bank.* This account was referred to as the "Wash Account," as simultaneously with the drawing of checks for salaries, etc., other checks

were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet (fol. 17) petitioner's compensation and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having charge of all the assets of such company) was in a position to draw checks on the account." (Italics ours.)

(Stipulation of Facts—Record, pp. 9-10.)

POINT I

Since petitioner was in the employ of the Insurance Department of the State of New York, engaged in carrying on a governmental function of the State, the source of his compensation is immaterial.

We respectfully submit that there are but two factors which are to be considered in determining whether or not petitioner's salary is exempt from Federal income tax. (1) Was he an employee of the State of New York? The fact that he was such employee was not questioned in the Court below, and could not be under the stipulated facts. (2) Was the petitioner engaged in carrying on a usual governmental function during the tax year in question? The learned Circuit Court of Appeals apparently an-

swered this question in the affirmative saying: "It is unnecessary for us to deal with the question as to whether the taxpayer, when acting as counsel for the liquidating bureau, was engaged by the State in the exercise of essential governmental powers. *It may well be that his activities were essential* • • •" (italics ours). The essential govermental function of the duties and activities of the State Superintendent of Insurance, his deputies and employees, is fully and satisfactorily established by the comprehensive review of the statutes and relevant cases in Point I of petitioner's brief, and need not be enlarged upon here.

The learned Court below, though finding in effect that the petitioner did not come within either of the two "situations" wherein Judge Hand stated that the immunity from taxation did not exist, proceeded to inject *a third factor,* namely, the *source* of the income.

We respectfully submit that there are no authorities lending support to the introduction of this "third factor" where the taxpayer is not subject to the infirmities of "situations" (1) and (2), as defined by Judge Hand. On the contrary, it is the character of the function engaged in which alone determines the application of the principle of governmental immunity in the case of officers and employees. The cases are many in which the taxpayer's compensation was held exempt from Federal tax even though received from sources other than the State itself. That factor does not alter the constitutional principle that governmental activities may not be taxed.

The sovereign must be free not alone to select its agents and employees, but to select its method of compensating them. The *interference* with the state and with its agents constitutes the burden. Hence, to tax a

state employee, because his compensation is paid out of *funds in the charge of the state* rather than from the state treasury, is to deprive the sovereign of this freedom to choose the method of compensation. This interference is the *burden* which this Court has always referred to in these employee cases. This was clear in the argument before this Court in the *Brush* case when the Attorney General argued that the City of New York collected revenues from the sale of water.

In the recent case of *New York ex rel. Rogers* v. *Graves*, 299 U. S. 401, the taxpayer's salary was paid not out of the United States Treasury, but out of the profits of the Panama R. R. Co. In that case, while the primary purpose of the enterprise was legitimately governmental, its incidental use was a business enterprise run for profit, for private purposes. In the instant case, no part or division of the Insurance Department of the State of New York constitutes a business enterprise. This Court held in the *Rogers* case that the salary of the taxpayer (the general counsel of the railroad company) was exempt from taxation.

It is submitted that petitioner as an employee of the State of New York is likewise entitled to immunity from the income tax of the Federal Government. In *The Collector* v. *Day* (1870), 11 Wall. 113, this Court, after referring to the case of *Dobbins* v. *The Commissioners* (1842), 16 Peters 435, stated at page 124:

> "And we shall now proceed to show that, under the same construction of that instrument (the Constitution), and for like reasons, that government is prohibited from taxing the salary of the judicial officer of a State".

The principle established in *The Collector* v. *Day, supra,* that the immunity of a State officer or employee from Federal tax is based on the same grounds as the immunity of a Federal officer from state tax has never been questioned by this Court.

In another case, only recently decided by this Court (*Brush* v. *Commissioner,* 300 U. S. 352), it was held that the salary of the Chief Engineer of the Board of Water Supply, New York City, was immune from Federal income tax. In that case, the *source* of the taxpayer's salary was not deemed to be vital. Yet the learned Court below attempted to distinguish both the *Rogers* case and the *Brush* case from the case at bar, saying:

> "In each instance it could properly be said that, *within the old rule,* there was a burden on the governmental enterprise and not, as here, a taxation of the salary of a state employee engaged in liquidating a private corporation and paid out of its property.". (Italics ours.)

The learned Court did not attempt to refer to any case which abrogated or even changed "the old rule". As far as we are aware, "the old rule", first laid down in *McCulloch* v. *Maryland,* 4 Wheaton 316, has been consistently followed to the present day. Many of the cases following *McCulloch* v. *Maryland* are collated and commented upon in petitioner's brief and no good purpose would be served by repeating them here.

The "burden" test is properly applied, not when the tax is assessed directly against a governmental activity (such as a tax on a state employee's salary), but only to determine whether a tax assessed against an independent contractor or a tax indirectly affecting a state will or will not, in fact, result in interference with governmental ac-

tivity. In the case of an employee, the interference is held to exist as a matter of law.

The learned Court below felt constrained to refuse to follow the Fifth Circuit in the case of *Therrel* v. *Commissioner,* 88 Fed. 2d. 869, where, as here, the taxpayer's compensation was paid by the State from funds it had received not from taxes turned into its general treasury, but from levies upon the assets of insolvent banks.

The learned Court below likewise frowned upon the decision of the Circuit Court of Appeals for the Fifth Circuit in *Hoskins* v. *Commissioner,* 84 Fed. 2d. 627, where again the compensation of the taxpayer was paid not out of the State Treasury nor out of the funds of the school district, but out of the gross income of a cafeteria which he was employed to supervise. In each of the two cases above referred to, the Court proceeded to determine whether or not the business in which the taxpayer was engaged was that of assisting in an essential governmental function, and also if he was an officer or employee of the State or of a political subdivision thereof. Answering those two questions in the affirmative, the Court in those cases quite properly gave no consideration to the *source* of the taxpayer's income.

The Third Circuit refused to follow the decision below and unanimously reversed the B. T. A. upon a set of facts not even as favorable to the petitioner as those in the case at bar (*Freedman* v. *Commissioner* (1937), C. C. A. 3rd, 92 Fed. (2nd) 150).

As was said in a well considered case and which has been quoted with approval on many occasions:

> "• • • That his services are compensated by fees and not by a salary, is of no importance. Many more important officials of the state are paid by fees. It is for the government which appoints

him to determine how he shall be paid, and he is no less a governmental official because paid by fees for services rendered than if paid a stipulated salary out of the treasury of the state.

The test as to whether a notary is engaged in the exercise of the governmental powers of the state does not depend upon how his compensation is provided. That is a matter for legislative regulation, and in no wise affects the nature or powers of the official who is so compensated. In Freedman *v.* Sigel, 10 Blatchf. 327, and Fed. Cas. No. 5,080, a tax upon the salary of a state judge was sought to be sustained upon the ground that his salary was fixed by the supervisors of the county, and paid out of the county treasury, and not by the state. Judge Shipman held that he was, nevertheless, a state official, and his salary exempt from federal taxation, although fixed and paid by a county of the state."

Bettman v. *Warwick,* 108 Fed. Rep. 46-48.

The principle at stake in these cases was well expressed by this Court in *Macallen Co.* v. *Massachusetts,* 279 U. S. 620, 628, where Mr. Justice Sutherland said:

> "Not only may the power to tax be exercised oppressively, but for one government—state or national—to lay a tax upon the instrumentalities or securities of the other is derogatory to the latter's dignity, subversive of its powers, and repugnant to its paramount authority."

The State may determine the methods of compensating its officers and employees. If it be argued that a "burden" upon the State must be shown (which we emphatically deny), the interference with the State's absolute right to determine the method is such "burden".

The State employed McLoughlin. He was engaged in carrying out a usual governmental function. The State

paid McLoughlin. How it reimbursed itself for that expense is irrelevant.

We submit that the order of the Circuit Court of Appeals for the Second Circuit should be reversed and petitioner's compensation received as an employee of the New York State Insurance Department be held exempt from Federal income tax.

POINT II

The order of the Circuit Court of Appeals for the Second Circuit should be reversed and petitioner's compensation received as an employee of the New York State Insurance Department be held exempt from Federal income tax.

Respectfully submitted,

JOHN J. BENNETT, JR.,
Attorney General of the State of New York.

Of Counsel:

HENRY EPSTEIN,
Solicitor General,

JOHN F. X. MCGOHEY,
COLIN MCLENNAN,
JOHN C. CRARY,
Assistant Attorneys General.

CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CLARENCE M. FREEDMAN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 23, 1937
CERTIORARI GRANTED DECEMBER 6, 1937

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CLARENCE M. FREEDMAN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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United States Board of Tax Appeals.

DOCKET NO. 79424.

CLARENCE M. FREEDMAN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Appearances:
For Taxpayer: JOHN W. TOWNSEND, ESQ.;
For Comm'r: R. N. MCMILLAN, ESQ.

DOCKET ENTRIES.

May 9, 1935.	Petition received and filed. Taxpayer notified. (Fee paid).
May 9, 1935.	Copy of petition served on General Counsel.
June 15, 1935.	Answer filed by General Counsel.
June 20, 1935.	Copy of answer served on taxpayer.
Sept. 28, 1935.	Hearing set Nov. 11, 1935.
Nov. 1, 1935.	Notice of appearance of John W. Townsend, as counsel for taxpayer filed.
Nov. 1, 1935.	Motion for continuance to 11/21/35 filed by taxpayer. 11/4/35 granted.
Nov. 21, 1935.	Hearing had before Mr. Arundell, Div. 7 on merits. Briefs due as per rules.

Dec. 2, 1935.	Transcript of hearing of Nov. 21, 1935 filed.
Jan. 6, 1936.	Request for findings of fact and brief filed by taxpayer. 1/7/36 copy served.
Feb. 4, 1936.	Brief filed by General Counsel.
Feb. 19, 1936.	Reply brief filed by taxpayer. 2/20/36 copy served.
Aug. 19, 1936.	Findings of fact and opinion rendered, Mr. Arundell, Div. 7. Decision will be entered for the Commissioner.
Aug. 21, 1936.	Decision entered, Mr. Arundell, Div. 7.
Sept. 4, 1936.	Motion for review by the Board filed by taxpayer.
Sept. 8, 1936.	Order denying Board review entered.
Nov. 17, 1936.	Petition for review by U. S. Circuit Court of Appeals (3) with assignments of error filed by taxpayer.
Nov. 17, 1936.	Proof of service filed.
Dec. 16, 1936.	Stipulation to correct transcript filed.
Dec. 16, 1936.	Agreed statement of evidence approved and ordered filed.
Dec. 16, 1936.	Agreed præcipe filed.

PETITION.

(Filed May 9, 1935.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 79424.

Clarence M. Freedman,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR;B-1, dated February 12, 1935, and as a basis of his proceeding alleges as follows:

1. The petitioner is a member of the Bar of Philadelphia County in the State of Pennsylvania, residing at 5323 Diamond Street, in the City of Philadelphia (formerly resided at 5307 Berks Street, Philadelphia).

2. The notice of deficiency, a copy of which is attached and marked Exhibit A, was mailed to the petitioner on February 12, 1935.

3. The taxes in controversy are the salary of the petitioner as an assistant attorney in the Department of Justice of the Commonwealth of Pennsylvania, assigned to the Department of Banking of the Commonwealth of Pennsylvania for the year 1932, and for the sum of $142.70.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

1. The tax is assessed against his salary as an employee of the Department of Justice of the Commonwealth of Pennsylvania, which said salary petitioner alleges is properly exempt from Federal income tax.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

1. The petitioner was an employee of the Commonwealth of Pennsylvania.

2. His position was specifically created by a statute of the Commonwealth of Pennsylvania.

3. His tenure of office, his compensation and his duties were fixed by law.

4. He was at all times subject to the direction and control of the Attorney General of the Commonwealth of Pennsylvania, the officer who appointed him.

5. To subject his salary to the Federal income tax would so burden the State as to constitute an interference through taxation by the Federal Government of the discharge by the Commonwealth of Pennsylvania of an essential governmental function.

WHEREFORE your petitioner prays that this Board may hear the proceeding and reverse the action of the Commissioner of Internal Revenue in assessing the deficiency hereinabove referred to.

CLARENCE M. FREEDMAN,
Petitioner.

STATE OF PENNSYLVANIA,
COUNTY OF PHILADELPHIA, } *ss.:*

CLARENCE M. FREEDMAN, being duly sworn according to law, deposes and says that he is the petitioner above named and that he is familiar with the statements contained herein, and that the facts stated are true and correct and that he believes that there is good ground for this petition and that the proceedings have not been instituted merely for delay.

CLARENCE M. FREEDMAN.

Sworn to and subscribed before me this seventh day of May, 1935.

C. ALMA SHEIP,
(Seal) *Notary Public.*
My commission expires January 24, 1937.

EXHIBIT A.

TREASURY DEPARTMENT
Washington

Feb 12, 1935.

Mr. Clarence M. Freedman,
5307 Berks Street,
Philadelphia, Pennsylvania.
Sir:

You are advised that the determination of your income tax liability for the year (s) 1932, discloses a deficiency of $142.70 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia

as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By Chas. T. Russell
Deputy Commissioner.

Enclosures:
Statement
Form 870

STATEMENT

IT:AR:B-1
MCB-90D

In re: Mr. Clarence M. Freedman,
5307 Berks Street,
Philadelphia, Pennsylvania

INCOME TAX LIABILITY

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1932	$205.39	$62.69	$142.70

Under date of December 11, 1934, a letter was mailed to you in which you were advised that the re-

view of your income tax return filed for the year 1932 in connection with the report of the internal revenue agent in charge, Philadelphia, Pennsylvania, disclosed a deficiency in tax of $142.70.

Under date of December 15, 1934, a letter was received from you in which it was intimated that the same issue was involved in the case of another attorney in your department assigned to bank liquidation work and that the decision in that case was still pending. No further information has been received. You are advised that this office holds that compensation received by you for services rendered to the Department of Banking of the Commonwealth of Pennsylvania must be included in gross income for Federal income tax purposes.

In order for the compensation received by an individual from a State or any political subdivision thereof to be exempt from Federal income tax it must be determined that it was received by him as an officer or employee of the State or political subdivision, and that to subject it to Federal income tax would so burden the State or political subdivision as to constitute an interference through taxation by the Federal Government with the discharge by the State or political subdivision of an essential governmental function.

General Counsel Memorandum #13488 published in Internal Revenue Bulletin XIII-35, page 9, provides that liquidation who are appointed to liquidate banks taken over by the State in Florida, whose compensation is paid from funds or assets of the bank being liquidated, are subject to Federal income tax.

In the case of Miller v. McCaughn (22 Fed. (2d) 165), the United States District Court, in holding that the compensation received by an auditor appointed by the Pennsylvania State Courts to report on the financial standing of corporations applying for approval as

sureties on bonds was not exempt from Federal income tax, stated:

> ". . . The compensation must not merely come to a State officer or employee, but it must come to him from the State to be exempt. Unless this second line is drawn and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the respondent might well be held to be such 'officer or employee' but in which the compensation does not come directly or indirectly from the State, otherwise than in the sense that he would not be in the enjoyment of it, were it not for the relation of officer or employee of the State which he enjoys.
>
> "Here what the plaintiff receives comes wholly from the surety companies upon whose financial resources he reports. . . ."

As stated above and in view of the foregoing it is held that the compensation received by you for services rendered to the Department of Banking of the Commonwealth of Pennsylvania must be included in gross income for Federal income tax purposes.

The original report of the internal revenue agent in charge, Philadelphia, Pennsylvania, covering an examination of your income tax liability for the year 1932, a copy of which was furnished you on June 8, 1934, has been reviewed and approved by this office. A synopsis of the return, as corrected, follows:

Net income reported on the return	$2,352.12
Plus:	
1. Salary	3,000.00
2. Bad debts disallowed as a deduction	141.50
3. Other deductions disallowed	73.75
Total net income as adjusted	$5,567.37

COMPUTATION OF TAX

Net income as adjusted		$5,567.37
Less:		
Personal exemption		1,000.00
Balance		$4,567.37
Normal tax at 4% on $4,000.00		$ 160.00
Normal tax at 8% on $567.37		45.39
Total tax assessable		$ 205.39
Tax previously assessed:		
Original	$54.08	
Additional	8.61	62.69
Deficiency in tax		$ 142.70

EXPLANATION OF CHANGES

1. This item has been explained above.

2. Bad debts of $141.50 have been disallowed, as a deduction for the reason that they have not been substantiated.

3. A deduction of $73.75 for maintenance and depreciation of auto used in business has been allowed. Since you claimed a deduction of $147.50, the amount of $73.75 has been restored to taxable income.

ANSWER.

(Filed June 15, 1935.)

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, in answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are for the year 1932, and for the sum of $142.70. Denies the remaining allegations contained in paragraph 3 of the petition.

4—1. Denies the errors alleged in paragraph 4-1 of the petition.

5—1 to 5, inclusive. Denies the allegations of fact set forth in subparagraphs 1 to 5 inclusive, of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Sgd.) ROBERT H. JACKSON,
Assistant General Counsel for the Bureau of Internal Revenue.

Of Counsel:

PAUL A. SEBASTIAN,
Special Attorney,
Bureau of Internal Revenue.

FINDINGS OF FACT AND OPINION.

(Rendered August 19, 1936.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 79424. PROMULGATED AUGUST 19, 1936.

CLARENCE M. FREEDMAN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Compensation received by petitioner for services rendered to the Department of Banking of Pennsylvania, *held,* not exempt from Federal income tax.

J. W. Townsend, Esq., for the petitioner.
R. N. McMillan, Esq., for the respondent.

This proceeding involves a deficiency in income tax for the year 1932 in the amount of $142.70. Only so much of the proposed deficiency is in controversy as arises from the respondent's addition to income of the sum of $3,000 received by the petitioner as compensation for services rendered to the Department of Banking of the Commonwealth of Pennsylvania. Petitioner contends that his compensation is exempt from tax on the ground that he was an employee of the commonwealth engaged in carrying on a governmental function.

FINDINGS OF FACT.

The petition is a lawyer, practicing his profession in Philadelphia, Pennsylvania. On October 2, 1931,

the attorney general of the Commonwealth of Pennsylvania directed to the petitioner a letter reading as follows:

> It gives me pleasure to appoint you an attorney in this Department assigned to the liquidation work of the Department of Banking. Your salary will be at the rate of $3,000.00 per annum.
>
> The Special Deputy Attorneys General who are assigned to this work in Philadelphia are being advised of your appointment and that you will be available to assist them in any way in which they may find it necessary to call upon you.

The petitioner accepted the appointment conferred by the above letter. He was thereafter continuously employed on matters relating to the liquidation of closed banks, as hereinafter more fully related, until March 9, 1935, when his employment was terminated on the occasion of a change in the political party in control of the state government, whereupon he was directed to turn his files over to his successor.

The department of justice and the department of banking are administrative divisions of the Commonwealth of Pennsylvania. The head of the department of justice is the attorney general and the head of the department of banking is the secretary of banking, these offices being provided for by statute. The attorney general has statutory power "to appoint and fix the compensation of Special Deputy Attorneys General and Special Attorneys to represent the Commonwealth, for any department, board, or commission thereof, in special work or in particular cases." Purdon's Penna. Stats., title 71, § 296. The secretary of banking is by statute given broad powers over banks within the commonwealth. When it appears to him that a bank is in an unsafe or unsound condition he may, after notice and hearing and with the consent of the attorney gen-

eral, take possession of the business and property of the bank; under certain conditions he may take possession without hearing and without the attorney general's consent. When he takes possession of a bank, he is vested with "all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonwealth"; while in possession of the bank he is "the representative of the creditors" thereof. The banking law provides that, in the case of banks the property of which is in the possession of the secretary of banking, all expenses in connection with such possession and of continuing the business or of liquidation "shall first be payable out of the funds of" such bank "including the compensation of special deputies, assistants, and others employed by the Secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the Court." Purdon's Penna. Stats., title 7, §§ 29, 49.

The petitioner was assigned to work under special deputy attorneys general in Philadelphia County in connection with legal matters pertaining to closed banks in that county. Such closed banks were being liquidated by the secretary of banking pursuant to statute. The petitioner's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the banking department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and "in general anything that was assigned by the Special Deputy Attorney General at the time."

Such attorneys were considered by the department of justice as "available for any purpose at any time."

The petitioner handled legal matters for the state banking department in connection with the liquidation of the Northern Central Trust Co., the Darby Bank & Trust Co., the United States Bank & Trust Co., the Central Trust & Savings Co., the Mortgage Security & Trust Co., the Park Trust Co., and the Wharton Trust Co., among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County.

The particular work and the matters to which the petitioner gave attention were determined by the attorney general's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the attorney general's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the attorney general and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the attorney general.

The petitioner's duties and the manner in which they should be performed were prescribed in part by a large number of mimeographed circulars issued by the attorney general at Harrisburg at frequent intervals and sent to all attorneys handling closed bank matters. Also, his instructions were received periodically from a deputy attorney general at regular meetings held for

the purpose of discussing their problems and deciding on procedure.

The petitioner received no compensation for his services other than his $3,000 salary, but was reimbursed for his expenses. He was furnished with necessary office facilities. He was required to use official letterheads furnished by the department of justice, and signed his letters as "attorney" for the department of justice. The files in matters handled by him were considered the property of the state and were turned over by him to his successor when his employment was terminated. While the department of justice could have required all his time and had first call on his services, he was permitted to engage in private practice. In 1932 he spent more than 50 percent of his time on state business. He had to give up certain regular employment to accept the employment in the department of justice. His professional income for 1932, aside from the $3,000 salary, was $2,735.60. He was not a member of a law firm.

Petitioner's salary was paid to him semimonthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the secretary of banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks whose assets had been taken over by the secretary of banking, but later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the petitioner's salary was charged were determined by the attorney general and the secretary of banking. The salaries of attorneys handling matters relating to the several closed banks were ordinarily paid out of the funds of such banks in approximate proportion to the amount of work done for each bank.

Petitioner did not include in his income tax return for 1932 the $3,000 salary received as compensation for services rendered to the department of banking.

OPINION.

ARUNDELL: This case involves the application of the principle of immunity of state instrumentalities from Federal taxation. As Mr. Chief Justice Hughes puts it in *Willcuts v. Bunn,* 282 U. S. 216, 225:

> The familiar aphorism is "that as the means and instrumentalities employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government". *Ambrosini v. United States,* 187 U. S. 1, 7.

Many of the recent cases involving this principle carefully point out, in juxtaposition with the statement of it, its limitations. "The limitation of this principle to its appropriate applications is also important to the successful working of the governmental system." *Willcuts v. Bunn, supra.* "It is a principle implied from the necessity of maintaining our dual system of government. . . . Springing from that necessity it does not extend beyond it." *Board of Trustees of the University of Illinois v. United States,* 289 U. S. 48, 59. "Of course, the reasons underlying the principle mark the limit of its range." *Indian Motocycle Co. v. United States,* 283 U. S. 570. "This Court, in drawing the line which defines the limits of the powers and immunities of state and national governments, is not intent upon a mechanical application of the rule that government instrumentalities are immune from taxation, regardless of the consequences to the operations of government." *Educational Films Corporation v. Ward,* 282 U. S. 379, 391.

The immunity question has many facets and in this case the parties are at odds on nearly all of them. They argue the questions of whether petitioner was either an officer or employee of the state; whether his services were rendered in connection with the exercise of an essential governmental function; the materiality of the source of his compensation; and whether the tax will result in any burden on the state.

Our conclusion, based on reasons hereinafter given,, is that the $3,000 compensation received by the petitioner in 1932 is not exempt from taxation by the Federal Government.

In the first place, we are not satisfied that petitioner can properly be classified as an employee of the Commonwealth of Pennsylvania. The facts are that in 1932 the petitioner, while appointed and supervised by the attorney general, was actually performing the duties of counsel for the liquidator for a group of banks in the Philadelphia area. The duties performed, as set out in the findings of fact, were those that would usually be performed by an attorney or receiver for insolvent corporations. These duties did not require all of his time, but left him free to follow his profession in private practice, which he did, resulting in income of $2,700 from outside sources. These considerations leave considerable doubt as to whether it can be said that petitioner was an employee of the commonwealth in the usually accepted sense of the term. His relation with the secretary of banking appears to be that of attorney and client rather than that of employee and employer.

The basic ground for denying the petitioner's claim to immunity from tax, however, is that the source of his income precludes any possibility of a burden on the state resulting from a tax thereon. We do not think it can seriously be urged that petitioner was com-

pensated by the state merely because his checks were issued by the officers of the state, as the fact is that both by statute and in actual practice the source of his compensation was the assets of the several banks in the process of liquidation. These assets were not public funds as are taxes; they were not susceptible of appropriation by the legislature for general public use; they were private property being administered by the secretary of banking in a fiduciary capacity. Therefore, if any burden falls elsewhere than on petitioner, it is on those banks or their creditors, for whose benefit the petitioner was acting, rather than on the state. We held in *Ned R. Harman,* 34 B. T. A. 654, that fees received by a statutory court reporter from litigants for transcripts of stenographic records are not exempt from tax because they are not paid by the state itself and no burden on the state was shown. Similarly, it has been held that the compensation of an auditor appointed by the Orphans' Court in Pennsylvania to report on the financial condition of corporations applying as sureties on bonds tendered to the court was taxable since it was paid out of deposits made by the surety companies for that purpose with the clerk of the court, and was not paid by the state itself. *Miller v. McCaughan,* 22 Fed. (2d) 165; affd., 27 Fed. (2d) 128. The District Court in that case pointed out that the "moneys paid are never in any sense public moneys" and held:

> The compensation must not merely come to a state officer or employee, but it must come to him from the state, to be exempt. Unless this second line is drawn, and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the recipient might well be held to be such "officer or employee," but in which the compensation does not come directly or indirectly from the state, otherwise

than in the sense that he would not be in the enjoyment of it, were not for the relation of officer or employee of the state which he enjoys.

The Circuit Court of Appeals for the Third Circuit, affirming the District Court, held that the taxpayer could not be regarded as an officer or employee of the state and also emphasized the lack of any burden on the state, saying:

> The exemption of state employees from federal income tax rests on the ground that the agencies the state employs in government should not be burdened by federal taxes, which would lessen the state's power to employ, and compel it to pay more for the services of its employees. But no such reason exists in the case of this examiner. No power of the state is crippled or lessened by his paying tax on his income. Neither the state nor the court pay Mr. Miller.

Following the Third Circuit in the *Miller* case, the Board, held, as one of the grounds for denying exemption in two cases decided by memorandum opinions, that no burden resulted to the state from taxation of compensation received from a source other than the state. *Robert S. Spangler,* Docket No. 46386 (1933); *Charles A. Roberts,* Docket No. 74214 (1934). In the *Spangler* case, the taxpayer was a "special attorney" appointed by the commissioner of banking of the State of Pennsylvania to represent him in the liquidation of a state bank and his compensation was paid out of the assets of the bank, and in the *Roberts* case the taxpayer was an attorney appointed by the superintendent of banks of the State of New York to assist in the liquidation of a trust company, his compensation being paid by the bank in liquidation. To the same effect see Mim. 3838, dated January 17, 1936, I. R. Bulletin XV, No. 5. Following the above cases it must be held here that the petitioner's compensation was not exempt from tax.

The petitioner advances the view that, once he has established himself to be an officer or employee of the state engaged in performing a governmental function, his immunity from Federal taxation is absolute, irrespective of the source of his compensation or of any other consideration. In view of the disposition that we have made of the petitioner's premise it is unnecessary to decide this matter, but it is worthy of brief note. The petitioner's contention is based on expressions in some of the cases to the effect that where the principle of immunity applies it is absolute and is not affected by the amount of tax or the extent of the resulting interference. Cf. *Indian Motocycle Co., supra.* This contention, often urged in tax cases, has its genesis in the apprehension expressed in *McCulloch v. Maryland,* 4 Wheat. 316, in the maxim that "The power to tax is the power to destroy." The cases quoted at the outset of this opinion establish that the courts are not stampeded into broadly granting exemption by the quotation of the *McCulloch* maxim. On the contrary, they inquire into all the facts and circumstances of the case. They inquire into whether an officer or employee is engaged in an essential governmental function, *Helvering v. Powers,* 293 U. S. 214; *Brush v. Commissioner,* —— Fed. (2d) ——; *Ohio v. Helvering,* 292 U. S. 360; whether the tax works any substantial interference with governmental functions, *Metcalf & Eddy v. Mitchell,* 269 U. S. 514; or whether it exerts but a remote influence, *Willcuts v. Bunn,* 282 U. S. 216; *Brush v. Commissioner, supra.* They also inquire, as we have here, into the source of the funds taxed, *Miller v. McCaughn, supra.* These cases indicate that the so-called rule of absolute immunity is not so broad in its application as is indicated by a literal reading of the words apart from the context of the case in which they are used. They also establish the right of inquiry into all

matters affecting petitioner's employment, including that of the source of the funds from which he receives his compensation.

In view of the conclusion we have reached we do not deem it necessary to discuss other arguments advanced.

Decision will be entered for respondent.

DECISION.

(Entered August 21, 1936.)

Pursuant to the determination of the Board, as set forth in its report promulgated August 19, 1936, it is

ORDERED and DECIDED: That there is a deficiency in income tax for the year 1932 in the amount of $142.70.

(Sgd.) C. ROGERS ARUNDELL,
Member.

PETITION FOR REVIEW AND ASSIGNMENT OF ERRORS.

(Filed November 17, 1936.)

IN THE UNITED STATES CIRCUIT COURT OF APPEALS,
FOR THE THIRD CIRCUIT.

B. T. A. DOCKET No. 79424.

Clarence M. Freedman,

Petitioner,

v.

Guy T. Helvering, Commissioner of Internal Revenue,
Respondent.

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now comes Clarence M. Freedman, by his attorney, John W. Townsend, and respectfully shows to the Court:

I. The petitioner on review, Clarence M. Freedman, is a citizen of the United States, a resident of Philadelphia, Pennsylvania, and an inhabitant of the judicial circuit of the United States Circuit Court of Appeals for the Third Circuit. He filed his Federal income tax return for the calendar year 1932 with the Collector of Internal Revenue for the First District of Pennsylvania, within said judicial circuit. The respondent, Guy T. Helvering, hereinafter referred to as the Commissioner, is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

H. The controversy involves the proper determination of the Federal income tax liability of petitioner for the calendar year 1932, the amount of taxes involved being approximately $142.70.

The petitioner is a lawyer, practicing his profession in Philadelphia, Pennsylvania. In October, 1931, the Attorney General of the Commonwealth of Pennsylvania appointed petitioner as an attorney in the Department of Justice of said Commonwealth, at a salary payable ot the rate of $3000 per annum, and assigned him to the liquidation work of the Department of Banking. Petitioner was thereafter continuously employed on matters relating to the liquidation of closed banks until March 9, 1935, when his employment was terminated on the occasion of a change of the party in the control of the state government.

Petitioner was an employee in the Department of Justice, and not an employee in nor responsible to the Department of Banking, these being separate and distinct administrative divisions of the Commonwealth of Pennsylvania. Petitioner's appointment was made pursuant to statutory authority authorizing the Attorney General to appoint and fix the compensation of attorneys employed to represent the Commonwealth in connection with the work of any department, board or commission.

The petitioner was assigned to work under Special Deputy Attorneys General in Philadelphia County, in connection with legal matters pertaining to closed banks in that county, although he was considered by the Department of Justice as "available for any purpose at any time". His services were rendered solely to the Commonwealth of Pennsylvania, and not to any private person or corporation.

The particular work and the matters to which the petitioner gave attention were determined by the Attor-

ney General's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the Attorney General's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the Attorney General and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the Attorney General. He was authorized to call on other attorneys similarly employed for assistance, and in turn was required to give assistance to them.

The petitioner's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the Banking Department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and "in general anything that was assigned by the Special Deputy Attorneys General at the time".

The petitioner handled legal matters for the Banking Department in connection with the liquidation of the Northern Central Trust Co., the Darby Bank & Trust Co., the United States Bank & Trust Co., the Cen-

tral Trust & Savings Co., the Mortgage Security & Trust Co., the Park Trust Co., and the Wharton Trust Co., among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County.

Petitioner received no compensation for his services other than his $3000 salary, but was reimbursed for his expenses. The obligation to pay him this salary was solely that of the state, and he looked to the state for its payment. His salary was paid to him semimonthly by checks drawn by representatives of the State Banking Department in charge of closed banks in Philadelphia, the checks being countersigned by the Secretary of Banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks whose assets had been taken over by the Secretary of Banking, but later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the petitioner's salary was charged were determined by the Attorney General and the Secretary of Banking.

Petitioner was furnished with necessary office facilities. He was required to use official letterheads furnished by the Department of Justice, and signed his letters as "attorney" for the Department of Justice. The files in matters handled by him were considered the property of the state and were turned over by him to his successor when his employment was terminated.

While the Department of Justice could have required all his time and had first call on his services, petitioner was permitted to engage in private practice. In 1932 he spent more than 50 percentum of his time on state business. He had to give up certain regular employment to accept the employment in the Department

of Justice. His professional income for 1932, aside from the $3000 salary, was $2735.60. He was not a member of a law firm.

Petitioner did not include his said $3000 salary in his 1932 Federal income tax return, the Commissioner having issued a ruling that same was not taxable. In his audit of such return the Commissioner included said salary in taxable net income, and accordingly determined a deficiency in income tax against the petitioner for the calendar year 1932 in the amount of $142.70. On February 12, 1935, pursuant to the provisions of Sec. 272 (a) of the Revenue Act of 1932, as amended by Sec. 501 of the Revenue Act of 1934, the Commissioner sent to petitioner, by registered mail, notice of said deficiency. Thereafter on May 9, 1935, petitioner filed an appeal from such notice of deficiency with the United States Board of Tax Appeals. A hearing before the Board on said appeal was held on November 21, 1935. On August 19, 1936, the Board promulgated its findings of fact and opinion, holding petitioner's said salary was taxable and affirming the Commissioner's determination. On August 21, 1936, the Board entered its final order of redetermination, deciding that there is a deficiency in petitioner's income tax for the year 1932 in the amount of $142.70.

III. Petitioner seeks a review of the Board's said decision of August 21, 1936, by virtue of the provisions of subdivision (a) of Sec. 1001 of the Revenue Act of 1926, as amended by Sec. 1101 of the Revenue Act of 1932.

IV. The petitioner on review says that in the record and proceedings before the United States Board of Tax Appeals, in its said opinion promulgated August 19, 1936, and in its said decision entered on August 21, 1936, manifest errors occurred to the prejudice

of the petitioner, and he asserts and assigns the following errors which he avers occurred:

1. The Board of Tax Appeals erred in holding that petitioner is liable for a deficiency of $140.72 in his 1932 income taxes.

2. The Board erred in holding that the $3000 salary received by petitioner in 1932, for services rendered as an attorney in the Department of Justice of the Commonwealth of Pennsylvania, is subject to taxation by the Federal Government.

3. The Board erred in failing to find that petitioner's services were rendered solely to the Commonwealth of Pennsylvania.

4. The Board erred in failing to find that the obligation to pay said salary to petitioner was solely that of the Commonwealth of Pennsylvania.

5. The Board erred in failing to find that the petitioner was a member of the legal staff of the Department of Justice of the Commonwealth of Pennsylvania and was responsible only to the officials of that Department.

6. The Board erred in failing to find that petitioner was authorized to call on other attorneys of the said Department of Justice, similarly employed, for assistance in legal matters turned over to him, and that he in turn was required to give assistance to them.

7. The Board's finding or holding that petitioner cannot properly be classified as having been an employee of the Commonwealth of Pennsylvania in the year 1932 is unsupported by any evidence.

8. The Board erred in failing to hold that petitioner was an employee of the Commonwealth of Pennsylvania during the year 1932.

9. The Board's finding or holding, if its opinion can be construed as so finding or holding, that the petitioner was employed by or was responsible to the Secretary of Banking of the Commonwealth of Pennsylvania is unsupported by any evidence.

10. The Board's finding or holding that petitioner's relation with said Secretary of Banking appears to be that of attorney and client is unsupported by any evidence.

11. The Board erred in failing to hold that the taxation of the compensation of an employee of a state is, in itself, a sufficient interference with the independence of and burden upon such state government as to invoke the rule of immunity.

12. The Board erred in holding that the source of the funds used by the Commonwealth of Pennsylvania to pay petitioner's said salary precludes any possibility of a burden on the state, resulting from a tax on said compensation.

13. The Board erred in failing to find that the petitioner was engaged in 1932 in the performance of usual governmental functions on behalf of the Commonwealth of Pennsylvania.

14. The Board erred in failing to hold that petitioner's immunity from Federal taxation in respect of his said salary is absolute, irrespective of the source of funds used in payment thereof, petitioner in 1932 having been a state employee engaged in performing usual governmental functions.

15. The Board erred in failing to find that the Department of Justice of Pennsylvania secured a ruling in 1933 from the Commissioner of Internal Revenue, holding that the salaries of attorneys employed as in the case of the petitioner were exempt from the

Federal income tax; that petitioner's return was examined by a Revenue Agent and petitioner advised by such agent that said salary was exempt; and that such rulings were subsequently reversed by the Commissioner.

WHEREFORE, the petitioner prays that the decision of the United States Board of Tax Appeals, entered in this proceeding on August 21, 1936, be reviewed by the United States Circuit Court of Appeals for the Third Circuit; that a transcript of record be prepared in accordance with the law and the rules of said court, and transmitted to the clerk of said court; and that appropriate action be taken to the end that the errors complained of may be corrected and reviewed by said court.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review,
1366 National Press Building,
Washington, D. C.

DISTRICT OF COLUMBIA, *ss.:*

JOHN W. TOWNSEND, being duly sworn, says that he is the attorney for the petitioner on review and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge, except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

Subscribed and sworn to before me this seventeenth day of November, 1936.

MARGUERITE G. DAVIS,
Notary Public, D. C.

NOTICE OF FILING PETTTION FOR REVIEW AND ASSIGNMENT OF ERRORS.

(Filed November 17, 1936.)

To Herman Oliphant, Esq.,
General Counsel for the Department of the Treasury,
Washington, D. C.

You are hereby notified that the petitioner on review in the above-entitled proceeding, did, on the seventeenth day of November, 1936, file with the clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for the review, by the United States Circuit Court of Appeals for the Third Circuit, of the decision of the Board of Tax Appeals heretofore rendered in this proceeding. A copy of such petition for review and of the assignment of errors as filed is hereto attached and served upon you.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

Dated November 17, 1936.

Personal service of the above notice, together with a copy of the said petition for review and assignment of errors mentioned therein, is hereby acknowledged this seventeenth day of November, 1936.

HERMAN OLIPHANT,
Attorney for Respondent on Review.

STATEMENT OF EVIDENCE.

(Filed December 16, 1936.)

The above-entitled cause came on for hearing before HON. C. ROGERS ARUNDELL, Member of the United States Board of Tax Appeals, on November 21, 1935, JOHN W. TOWNSEND, ESQ., representing the petitioner and R. N. MCMILLAN, ESQ., representing the respondent. The following is a statement of all the evidence adduced at the hearing which is essential to the decision of the questions raised by the assignment of errors set out in the petition for review.

CLARENCE M. FREEDMAN, the petitioner herein, called as a witness in his own behalf, testified as follows:

I reside at 5323 Diamond Street, Philadelphia, Pennsylvania. I am a member of the bar of Philadelphia County and have practiced law seven years in Philadelphia County.

There was received in evidence as Petitioner's Exhibit 1 letter dated October 2, 1931, from William A. Schnader, the then Attorney General of the Commonwealth of Pennsylvania, directed to the petitioner, the material part of which is quoted in the Board's findings of fact.

I accepted the appointment made in such letter by writing to the Attorney General and advising him that I would be pleased to accept. I did not take an oath of office because I understood I was an employee of the Commonwealth of Pennsylvania and not an officer. Officers are the only ones required to take an oath of office. Employees are not. I served as an attorney in the Department of Justice pursuant to that appointment until March 9, 1935.

There was received in evidence as Petitioner's Exhibit 2 a letter dated March 7, 1935, from Charles J. Margiotti, Attorney General of Pennsylvania, directed to the petitioner, the material part of which reads as follows:

> "You are hereby notified that your services as attorney representing the Department of Banking will terminate as of March 9, 1935.
>
> Will you kindly turn over to Israel Finkelstein, who has been appointed to succeed you, all files and other data belonging to this Department which you have in your possession."

There was received in evidence as Petitioner's Exhibit 3 a letter dated January 12, 1935, directed to petitioner, from William A. Schnader, Attorney General, Department of Justice of Pennsylvania, the material part of which reads as follows:

> "Before I leave office as Attorney General I desire to thank you for the splendid cooperation which you have given me in the performance of your work as a member of the staff of the Department of Justice.
>
> I am satisfied that the depositors of closed banks have benefited to the extent of millions of dollars through the energetic, efficient and loyal services of our closed bank attorneys.
>
> The Commonwealth is indebted to everyone of them."

My employment was terminated by reason of the going out of office of the Attorney General and the appointment of my successor in office by Charles J. Margiotti, the new Attorney General, of a different political faith. My service as such attorney was continuous from October 2, 1931, to March 9, 1935. My salary remained the same throughout that period.

During the year 1932 I received $3000. as salary for such services. I did not include that amount in my tax return.

At this point witness identified his original 1932 income tax return which was received in evidence as Petitioner's Exhibit 4. So far as material to the issues raised by the assignment of errors such exhibit shows that petitioner reported the sum of $2735.60 as his income from business or profession; that he designated himself as a lawyer; and that there was not included in such return any amount received on account of the compensation involved in this proceeding.

My return was examined by a revenue agent. The first action was to advise me that the position of the Government was that my salary as attorney for the Department of Justice was taxable. We had a conference in Philadelphia. The authorities cited by me were checked. I took the matter up with the Department of Justice of Pennsylvania with the result that I was advised that my salary was exempt. Some time later on the Bureau here in Washington ruled against my contention. I don't think I filed a protest. I simply took an appeal after I was notified of the time in which I could take an appeal. Prior to the time I filed my return, and the reason I did not include my salary, was that the Department of Justice in Pennsylvania had taken the matter up with the Commissioner of Internal Revenue in Washington and had secured a ruling which was submitted to all attorneys in the form of a memorandum to the effect that our salaries were not taxable; and for that reason I did not include it.

There was received in evidence as Petitioner's Exhibit 5 a copy of the memorandum dated March 6, 1933, from the Department of Justice of Pennsylvania directed to all attorneys representing the Secretary of Banking in possession of closed banks and trust companies, quoting a copy of a letter addressed by W. T.

Sherwood, Acting Deputy Commissioner of Internal Revenue, to Special Deputy Attorney General Shippen Lewis on March 2, 1933, which quotation reads as follows:

> "Reference is made to your letter of January 25, 1933, requesting a ruling with regard to whether salaries paid to attorneys employed by the Secretary of Banking of the Commonwealth of Pennsylvania, hereinafter referred to as the Secretary, or the Secretary of Banking, are subject to Federal income tax.
>
> In accordance with the provisions of the Banking Act of 1923 of the Commonwealth of Pennsylvania, the Secretary has authority to take possession of the business and property of any bank or trust company which is in unsafe or unsound condition. He is empowered to appoint special deputies or agents to assist him in conducting or liquidating the business or affairs of any corporation or person in his possession. He may also employ such legal counsel as he may deem necessary in the continuation or liquidation and distribution of the assets.
>
> You state that with few exceptions the attorneys designated by the Attorney General, and approved by the Secretary of Banking for legal work in connection with the closed banks, are paid flat annual salaries. The attorneys are not bonded and take no oath. They are designated by letters addressed to them by the Attorney General. The majority of them are paid from the assets of the bank to which they are assigned, although a few are doing general supervisory work are paid by contributions from all closed banks.
>
> In order for the compensation received by an individual from a state or any political subdivision thereof to be exempt from Federal income tax it

must have been received by him as an officer or employee of the state, or a political subdivision thereof, engaged in the discharge of an essential governmental function. An officer is a person who occupies a position in the service of a state or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not in the accomplishment of specific objects, and whose services are continuous, not occasional or temporary.

It does not appear that these attorneys are officers of the Commonwealth of Pennsylvania or any political subdivision thereof as their duties are not prescribed by statute; they take no oath of office and there is no term designated by statute during which they shall serve.

If the attorneys in question are in the continuous employ of the Banking Department of the state, that is if they are employed by the year to do whatever work is assigned to them by the Superintendent or someone designated by the Superintendent, they are considered employees of the Banking Department, the work of which constitutes the discharge of a governmental function, and their compensation is, therefore, exempt from Federal income tax.

In the cases of attorneys appointed to act in specific cases, who are paid on the basis of the particular work done, they are not considered employees of the State of Pennsylvania or any political subdivision thereof and their compensation is, therefore, subject to Federal income tax on the basis of the decisions in the cases of Metcalf & Eddy v. Mitchell, 269 U. S. 514; Lucas, Commis-

sioner, v. Reed, 281 U. S. 699 (34 Fed. 2nd 263) Commissioner v. Howard, 280 U. S. 526 (29 Fed. 2nd 895) and Blair v. Byers, 35 Fed. (2nd) 326."

There was received in evidence as Petitioner's Exhibit 6 copy of the deficiency notice dated February 12, 1935, which is the basis of this proceeding, and a complete copy of which is attached as Exhibit A to the petition, which is a part of the record herein.

My letter of appointment stated that I would work with the Special Deputy Attorneys General in Philadelphia County in connection with legal matters pertaining to the liquidation of closed banks in Philadelphia County and such other work which they saw fit to assign to me. I immediately reported to those men, and shortly thereafter I was assigned to the regular legal work in connection with two or three of the closed banks that had been taken over within the preceding week, and continuously thereafter I applied myself to that work, which was attempting collection of outstanding indebtedness to the banks and the making of various legal opinions to the Deputy Receivers in Charge. At that time there were no Special Deputies or Special Agents in Charge of banks. I was also asked to take charge of whatever legal matters that came up from surrounding counties. For instance, there were a number of bankruptcies in surrounding counties and I was assigned to take charge of that work, which involved the bringing of suits wherever necessary, consultation with creditors of the banks as well as depositors and stockholders, who came in for information concerning some of those banks, and in general anything that was assigned by the Special Deputy Attorney General at that time. Of course, as time went on there was other work in connection with the banks, such as the procuring of substitute trustees for trust estates, the filing of accounts, preparation of accounts, presenting them in

court, appearance before the Orphans' Court, and in general all matters concerning the liquidation of a considerable number of banks in Philadelphia.

The first work I had related to the Northern Central Trust Company, one of the banks taken over. Subsequent to that I was assigned to the Mortgage Security Company, the Park Trust Company, and the Wharton Trust Company.

For the first three months I received no salary, until the Attorney General had a consultation with the Secretary of Banking to determine just the manner in which our salaries were to be paid. Finally it was determined that my salary would be paid by three banks in the beginning—the Wharton Title and Trust Company, the Park Trust Company and the Mortgage Security Company. However, that did not mean that any work I had started with other banks, such as the Darby Bank and Trust Company, Northern Central, and one or two others, was to be discontinued. I carried on that work just the same, although I received no money from the Northern Central Trust Company, and continued on the work of that bank as well as the Darby until well into the summer of 1934. Subsequent to that time there were a number of other banks, such as the United States Bank and Trust Company, the Central Trust and Savings Company, and others, banks in connection with which the Deputy Receivers thought they could call upon me at any time, rather than upon any of the other members of the Department of Justice staff in Philadelphia County.

The particular work and the particular matters to which I should give attention were determined by the Attorney General's office. My immediate superior in the beginning was Harold Saylor, Deputy Attorney General. The work became so great that the work in Philadelphia was taken over by Special Deputy Attorney General Shippen Lewis. Mr. Saylor was assigned

to the Department of Banking for the entire state of Pennsylvania, and Shippen Lewis took over the work in Philadelphia. His position was Special Deputy Attorney General.

There were a number of other attorneys who held positions similar to mine. There were approximately twenty men in Philadelphia County.

On instructions from the Attorney General's office I handled litigation for the Department of Banking. I entered my appearance as attorney for the Secretary of Banking in possession of the business and property of whatever particular bank it happened to be. In connection with some banks only my appearance was entered. In others I was associated with other attorneys. In some cases we entered our appearances together. In one particular bank I had associated with me Mr. Charles W. Coulston. In other cases I entered my own appearance, depending upon the necessities of the case.

I was free to handle cases according to my own discretion only in very simple matters. I was generally instructed by, or consulted with, first Mr. Saylor and afterwards, Mr. Lewis. From time to time there were sent regular prescribed forms for pleadings, which were established by the Attorney General's office in Harrisburg, and we were instructed to follow them in all our pleadings. Practically all of the papers that were filed in court were in accordance with prescribed forms.

Witness identified three papers as being some of the earlier forms that were submitted for his use. One was called a "suggestion of Record" in connection with the taking over of a particular bank by the Secretary of Banking. It was headed "Appointment of Appraisers," and suggested of record that the Secretary of Banking, who was in possession of the business and property of the company, did appoint

two persons as appraisers of its assets. Another form was for appearances, addressed to the prothonotary of the court, asking him to enter the appearance of (attorney) for the Secretary of Banking, who was in possession of the business and property of the company, and , the Secretary's Special Deputy as Agent.

I received those forms from Harrisburg. Another form had to do with the appointment of the Special Deputy Agent in Charge. All these forms were mimeographed and were decided upon at Harrisburg. We just filled in our names in the blanks. These forms were representative of a large group of forms. We used to get from two or four to six forms a day. I might say that I turned over all my files to my successor in office when I received the letter terminating my services, which required that this be done, and we had to get some of these forms. They are not complete by a long shot. We had to get them from somebody to bring them here today. There was received in evidence as Petitioner's Exhibit 7 the aforementioned three sample forms, marked Form 120-1, Form 120-2 and Form 120-3, respectively.

There was received in evidence as Petitioner's Exhibit 8 a letter dated March 29, 1932, from William A. Schnader, Attorney General, directed to petitioner, reading as follows:

> "There is now in course of preparation by this department a revised code of the banking laws of the Commonwealth for introduction at the next regular session of the Legislature in 1933. Recent experience has shown the necessity of changes in the law for the better protection of the public dealing with banks and trust companies and for more complete control and supervision over the latter by the Department of Banking.

> As attorneys have frequent opportunities to observe the results of unwise, unbusinesslike and even illegal practices on the part of bank officers and directors in State institutions you may have suggestions for amendments to existing laws. I will appreciate any assistance you may give me in preparing the new code and will welcome suggestions from you.
>
> As the work must proceed with due dispatch so that it can be completed by September first this year, I am hopeful that I may receive your suggestions and recommendations in the near future."

I actually rendered some service in connection with an opinion regarding the code mentioned in that letter.

My opinions were subsequently reviewed before being adopted by the person for whom I wrote them, first by Mr. Saylor, and then by Mr. Lewis. Appeals were authorized by the same two gentlemen unless they were in conflict. We were at liberty to draft briefs, but sometimes after we got them back we did not recognize them. They were reviewed by my superiors.

My duties were prescribed by no specific instructions. Generally all the work in connection with the liquidation of the closed banks in the Philadelphia area was under the direction of the Attorney General. I received a continuous stream of written instructions as to them. For instance, when the Home Owners Loan Corporation came into existence, that gave rise to special matters, and immediately we were given instructions about those cases, and also in connection with filing accounts, the making of substitute trustees, etc., all those being matters of general concern to the 165 closed banks in Pennsylvania. All that was decided upon in Harrisburg and the policy they decided upon

was transmitted to us for handling. The method used in giving such instructions was by memoranda prepared by the Attorney General's office, first by the Attorney General himself, and immediately thereafter by a Deputy Attorney General, Harold Saylor, and in 1932 by Special Deputy Attorney General, Shippen Lewis, in connection with Harold Saylor. Witness was handed a package of documents about three inches high and identified the same as just a few of the instructions received. I have looked through those I was able to get hold of and have laid aside a few of them.

There was received in evidence as Petitioner's Exhibits 9 to 18, both inclusive, ten circular instructions, simply as examples of the instructions sent to petitioner by the Department of Justice.

I might add that, in addition to written instructions, which were very minor, we had meetings of all the attorneys every Friday afternoon for the first six months we were assigned to that work, at which time the problems which came up were discussed, and Mr. Saylor, the Deputy Attorney General assigned to the Banking Department, was in charge and he decided the procedure. Anything that arose above an ordinary plain suit on a note was brought into those conferences and was decided by him. Later on the meetings were held twice a month and then once a month.

The Attorney General and the Secretary of Banking between themselves determined how my salary should be divided. It was first divided among three banks, and then four, and then finally from one particular bank. In 1932, from the beginning of the year it was divided among three banks, and at the end of the year, four banks.

I received my salary by check drawn by the Deputy Receiver of the bank, countersigned by the special agent, and signed by the Secretary of Banking in Harrisburg. I got these checks on the first and fifteenth of each month—$125 on the first and $125 on the fifteenth. The several checks aggregated $3000 for the year.

I think that in the beginning of the year it was divided into 17 per cent., 38 per cent. and 45 per cent. Toward the end of the year we got another bank and I think 4 per cent. or 5 per cent. was taken from one bank and put on the other bank. That was no different from all other work in connection with the banks. It was first set by the Attorney General and divided among the different banks. I got the first of those banks.

My $3000 salary covered all the work I did for the department, even though I examined other banks and worked for others than those that were actually contributing to my salary. Toward the end it was just one bank, at the end of 1933.

I had an expense account made up of long distance telephone calls and various other items of that kind. We got instructions as to how to itemize these and submit them to the Special Deputy Attorney General once a month.

I did not use my own letterheads. I used the letterhead of the Commonwealth of Pennsylvania, Department of Justice. I was not permitted to use my own stationery in connection with my official work.

There was received in evidence as Petitioner's Exhibit 19 a letterhead and envelope as a sample of the forms used by petitioner and other attorneys. There is a central heading "Commonwealth of Pennsylvania, Department of Justice" and the imprint of the coat of arms of the State of Pennsylvania.

I was not required to use my own office. We had the necessary facilities. I signed letters "Department of Justice", then my own name, and under it "attorney".

The files relating to my official work were turned over to Mr. Finkelstein, who succeeded me, two days after my employment was terminated.

I was permitted to engage in private practice in my spare time. The department could have required all my time. That work came first all the time. I was forced to give up certain other work I had in Philadelphia at that time. I was operating in an office which had quite an extensive business. I received certain compensation for taking care of certain work in that office. When I received my appointment I could not give it my attention and I was forced to drop all that work. I was not a member of any law firm.

If any work in connection with any particular bank became heavy I could call upon some of the other men in the department. Sometimes they would call on me in connection with an account of affairs. I helped a number of other men prepare their memoranda and briefs. The accounts were not all filed at the same time. Some were filed one month and some another. Even where they were filed together they might have been made at different times.

The character of my employment did not change during the remainder of my term, after 1932 and until the termination of my service in 1935. There was certain special work that came up in the latter part, such as transferring our assets to the Reconstruction Finance Corporation. The method of handling the work was the same.

In 1932 the basic state statute pursuant to which the Department of Banking took over possession of the banks was the Banking Act of 1923 as amended.

That is not the present law. In 1933 the Banking Code was passed. I have referred to the work I did in connection with that code. That superseded the Act of 1923.

Upon cross-examination such witness testified:

It is hard to figure out how much time per day I spent in 1932 on the bank work. There were some days in 1932 that I spent all day and sometimes worked at night. Some of the particular banks I was working on at that time were in various sections of the city and I used to run all over the south part up into the north section and be at my desk to keep appointments at various times. Sometimes I spent the whole day in a bank; sometimes half a day. In 1932 I spent more than 50 percentum of my time in the bank work. That is a conservative estimate. I don't count Sundays. I don't want to exaggerate. I don't count the times I went down on Sundays to prepare briefs.

In 1932, shortly after these banks were taken over, there were depositors coming into those banks each day. Some had balances, some had loans. Questions were coming up that required explanation. I was there at the bank trying to advise these depositors that were anxious to settle. That took a lot of time. A number of banks had trust estates, in one case more than a half million, and in another case $650,000. The heirs came in and wanted to know how they could get their money or how they could get their accounts transferred, or what-not. In answer to the question, "Did you have to get the consent of the Attorney General to give that information to those depositors and other people?" witness testified that on the question of a set-off or something of that kind I couldn't give any information until it was decided what the policy of the department was. The law of Pennsylvania is

somewhat peculiar on the question of set-offs, and there were no decisions of the courts until the early part of 1933, so that the department had to formulate a policy at the beginning of 1932 and we applied that to each particular case. I had authority to advise clients of the banks only when the policy had been established as to the particular matter. If a question arose in a case which was different from the procedure established I told the people to come back a week or two later, and in that Friday conference I raised the question and we discussed it and the policy was decided upon. When they came back the following week I told them.

Mr. Saylor was a full-time Deputy Attorney General who was assigned to the Department of Banking, opened and closed banks and everything else. He rendered official decisions in these conferences, as an official of the Department of Justice. He was authorized to render decisions for the Attorney General in certain matters. In other cases it took sometimes two or three weeks until the conference would have an opinion come back to us. There were a million and one things coming up in these closed banks. There were over thirty-one in Philadelphia County, and millions of dollars involved. It was a pretty tough job we had at the time. Things that were never thought of came up every day.

The Attorney General assigned the particular banks from which we would get our salaries, but under the supervision of Mr. Saylor or Mr. Lewis, if any other work would come up, we would do it.

The Department of Banking had absolutely no authority over me. They did not instruct me as to what banks I was to work. The Attorney General did that. A special agent from the Department of Banking was in control and charge of each of these banks. There

were four or five different special agents or receivers who were directed to come to me for opinions. I was an adviser of those agents in charge.

HAROLD D. SAYLOR, being called as a witness on behalf of petitioner, testified as follows:

I reside at Germantown, Philadelphia, Pennsylvania. I am an attorney-at-law with offices at 123 South Broad Street, Philadelphia. In 1932 I was Deputy Attorney General of Pennsylvania. I was a full-time employee.

The executive branch of the government of Pennsylvania is headed by the Governor, with a cabinet consisting of twenty to twenty-two heads of departments, which are under the administrative division of the government. One is the Department of Justice, headed by the Attorney General. Another is the Department of Banking headed by the Secretary of Banking. The Attorney General had under him at all times at Harrisburg ten deputies and several assistant deputies, and had in different parts of the state special deputy attorneys general. In addition to that he had in nearly every county special counsel to handle special work in that county, and in 1931 he had a total of seventy or seventy-five attorneys acting for him in representing the Department of Banking in connection with the closed banking institutions of the state.

Every one of these attorneys who represented the Department of Banking was directed by the Attorney General himself. There was no attorney in the State of Pennsylvania, acting for the Commonwealth in any capacity or representing any department or any commission, who was not appointed by the Attorney General. It was illegal for any state officer to employ an attorney without the consent and approval of the Attorney General.

When the banks began to close rather rapidly, beginning in the summer of 1931, and continuing at the rate of two or three a day, the Attorney General was faced with a very serious problem to get proper representation for the Department of Banking in taking over these closed banks and trust companies, and he appointed attorneys rather rapidly. He called them in consultation and instructed them in their duties. A large part of that devolved upon me, because I represented the Department of Banking. It was necessary to have someone take my place in charge of the closed banks. I had to be at Harrisburg nine-tenths of the time. I had to go to Philadelphia once a week and there meet with these attorneys, and, as a result of the problems brought before us, we gradually evolved a set of instructions and rules and regulations which were sent to all seventy or seventy-five attorneys.

That work, direct charge of these banks, was placed in the hands of Shippen Lewis, who was designated Special Deputy Attorney General for that purpose. He and I consulted almost daily over the telephone. All the work of those banks in our Department of Justice was kept before the Attorney General by frequent reports. I was with him practically every day. One of the most important things I recall in his instructions in connection with these attorneys or special deputies was that no steps should be taken or opinion rendered on any legal problems involving closed banks without the approval of the Attorney General himself. It was for that reason that we instructed these men not to take positions with respect to matters that were not Hornbook law without getting our position and authority. That was the reason for these frequent discussions with these men.

From time to time cases in which depositors were interested were decided, in relation to various ones of

the sixty-seven counties. We would immediately mimeograph those opinions and send them out to this group of assistant attorneys in advance of their publication in the reports. We also had the attorneys come to Harrisburg, if need be, when particularly pressing problems engaged their attention that had not been decided before. We would consider the facts and determine the policy to be pursued.

In all cases where there was litigation, no steps could be taken without the approval of Mr. Lewis. Whenever there was an appeal from a court of primary jurisdiction to the Superior or the Supreme Courts of Pennsylvania, we insisted that the briefs be sent to Mr. Lewis for his editing, and he would send them to Harrisburg and they would be edited there and printed there.

Sometimes we called in attorneys from different parts of the state to assist us in matters with which they were familiar. I recall very well one attorney occupying a position similar to the one Mr. Freedman had, who, by reason of his experience in appellate matters, was called in to assist us in some litigation that later went to the Supreme Court of the United States. That was true of any and all of these men. It was considered that these men were available for any purpose at any time with the Department of Justice. They were controlled entirely by that department.

In Pennsylvania for a number of years it has been the regular practice and the law that any bank or trust company or private bank or any institution that receives deposits is subject entirely to the supervision of the Department of Banking. There was an exception in respect to certain private banks, such as Drexel & Co. and Brown Bros. & Co. Over every other institution it had complete control as to banking practices and so on. If any of those were found to be in unsound

or unsafe condition, or there was an impairment of capital or surplus or deposits, the Secretary of Banking was charged with the duty and had the authority to take possession of such institutions, and, if he deemed it insolvent, to liquidate its affairs. The law also provided that if any court appointed anybody as a receiver or trustee in bankruptcy, the Secretary, upon application by the Attorney General, could immediately succeed such receiver or trustee. He had complete control and supervision over all banking institutions when they closed. His first job was to send an examiner. If he found the bank was in such shape it should not open, he closed it. These examiners were usually made acting deputies or special agents in charge. As soon as a permanent special deputy could be employed the examiner was returned to his regular duties. This special deputy was authorized to keep such members of the staff of the old bank as he found necessary and when he took charge to safeguard the assets of the closed bank. An attorney was assigned to represent that bank by the Attorney General.

The Banking Department was not at liberty to engage counsel, except those employed by the Department of Justice and assigned to the Department of Banking for that purpose.

"Q. How were the attorneys in your department paid, who were assigned to that work? When were they paid, and by whom?

A. All of the attorneys in the Department of Justice were employees of the Commonwealth of Pennsylvania. All of us in Harrisburg, who represented departments of the government, doing work for the government, were paid out of the state treasury. All the deputy attorneys general were paid from the state treasury. All the deputy attorneys general in the Banking Department, however, the employees, stenographers, clerks and

examiners, and so on, were paid by the state treasurer from a particular fund known as the Department of Banking fund, made up of assessments levied on the open banking institutions and paid to the state treasury to reimburse the Commonwealth. When a bank closed the special deputy who was in charge as a representative of the Department of Banking was expected to pay all the expense of liquidating the closed bank out of the assets of the bank. That included payment of salaries of counsel assigned by the Department of Justice to the bank. (R. 45-46.)

It was at first thought advisable, when they established a fund at Harrisburg to take care of the Department of Banking expenses in connection with closed bank work, to have some central office through which all that work could be cleared and cut down overlapping and effect a more efficient liquidation of the assets. For example, in Philadelphia we had some thirty closed banks. It was obvious that if each deputy operated independently he might be in conflict with other deputies or in competition with other deputies in the sale of real estate, and so forth. Instead of creating a central bureau at Harrisburg, one was created at Philadelphia.

From that fund all salaries were paid. They were paid out of a central fund, but kept separate so far as the assets of the different banks were concerned. It was decided to pay these attorneys out of these funds of the closed banks for which they were working in proportion to the amount of work each one did for the particular closed bank or banks to which he was assigned. They arranged for payment in that manner, and payment was made from the assets of the banks to these attorneys by check drawn on the assets and counter-

signed by the Department of Banking at Harrisburg.

Q. Was there a different procedure in connection with the payment of attorneys engaged in connection with open banks from attorneys engaged in connection with closed banks? (R. 46-47.)

A. Yes; because of the necessities of the situation.

Q. Suppose the assets of some bank to which an attorney was assigned were insufficient to pay his salary, to whom would he look for his salary?

A. He was employed by our department. I suppose we would have to get the money for him somewhere. If the man did the work we would want to pay him.

Q. Do you know of any instances of that kind?

A. I don't recall any during my connection with the Department of Justice at Harrisburg. I ceased that connection on January 15 of this year and have since been in private practice. I do know that a representative of the Secretary of Banking was appointed receiver of the E. T. Wilbur Trust Company, a bank in Bethlehem, by the court, and represented the bank in the reorganization process. It had no assets. He would have to be paid from the general fund at Harrisburg, I expect, in that case.

Q. You say, with respect to the normal operation of the banking department, that is by assessments on banks under its control?

A. Yes.

Q. And you create a special fund?

A. Yes.

Q. Out of which department employees are paid, and attorneys assigned to the Department of Banking? (R. 47-48.)

A. The law provides they shall be paid by the Banking Department. Normally, all salaries

should be paid by the Banking Department for work in behalf of any bank under its supervision, but I presume where a man was working for five or six different banks it might be sometimes difficult to arrive at the proper amount. It is the law of Pennsylvania that all attorneys, as well as special and regular deputies, representing the Department of Banking, shall be paid from that fund made up of assessments upon going concerns under the supervision of the Secretary of Banking.

Q. That fund, out of which these attorneys, like Mr. Freedman, were paid, was under the actual control and supervision of officials of the State of Pennsylvania?

A. No one but the Secretary of Banking or his deputy could transfer or sell any assets of those banks. All cash and mortgages and notes and choses in action were under his supervision.

By THE MEMBER:

Q. The title to the assets was in the banks?

A. No, sir; in the Secretary of Banking. No title was in the bank when it closed. Title to all the property of a closed bank was taken in the name of the Secretary of Banking, William D. Gordon.

Q. Taken in trust for the creditors and stockholders of the bank? (R. 48-49.)

A. Exactly.

Q. And not in trust for the Commonwealth of Pennsylvania?

A. Oh, no. It was for the benefit of depositors and creditors.

By MR. TOWNSEND:

Q. But wasn't it true that, to the extent that the Department of Banking had assets subject to administrative expense, it asserted a prior claim in behalf of Pennsylvania?

A. Absolutely, and had to under the law.

Q. That was in effect an assessment on the assets which was appropriated to the salary of Mr. Freedman and other like employees, just the same as a fund created by an assessment against live banks was appropriated for expenses of the department?

A. I would say yes, except there were different funds, whereas at Harrisburg there was no other fund.

By The Member:

Q. That assessment on open banks was pursuant to the law?

A. Yes, sir.

Q. These assessments were paid into the state treasury?

A. Yes, sir.

Q. And became a part of the funds of the State of Pennsylvania?

A. Yes, sir. (R. 49.)

Q. And were taken from those funds by the appropriation?

A. No, sir; it didn't become a part of the general fund of the State of Pennsylvania. It became a part of the special fund of the State of Pennsylvania known as the Department of Banking fund. It was from that fund that all expenses of the Department of Banking were paid. I think the reason for that was they didn't want to be in the embarrassing position some time of having to make a good many examinations of banks and banking institutions and not having the appropriation with which to do it. If they had a special fund they could immediately send out examiners to take charge of the banks and the funds, and they could be built up again.

Q. Was the fund in different percentages, or was it in the same amount?

A. It was a definite fund in the hands of the Secretary of Banking.

THE MEMBER: Go ahead, Mr. Townsend.

By MR. TOWNSEND:

Q. Was there any particular reason why the same fund was not used in connection with closed banks?

A. There may have been a reason that they didn't consider that open banks should bear the expense of taking care of closed banks. As far as the expense is concerned, they didn't want to have the extra expense of maintaining another fund at Harrisburg and have the Treasury Department burdened with extra details that would be necessary by paying it through the Harrisburg fund. (R. 50-51.)

Q. The difference in the schemes used in paying attorneys assigned to closed banks and open banks was just a matter of convenience and economy of operation?

A. It was that they accepted the difference between a closed and open bank. "I don't see any reason why they didn't have two different funds, one for closed banks and one for open banks. There is no difference in principle at all." (R. 51.)

WHEREUPON the petitioner's case was closed.

The respondent produced no witnesses in his behalf. There was received in evidence, as Respondent's Exhibit A, an interoffice memorandum dated November 30, 1934, from L. K. Sunderlin, Chief of the Rules and Regulations Section of the Income Tax Unit, Bureau of Internal Revenue, and approved by Deputy Commissioner Russell to Mr. H. B. Robinson, Head of the Audit Review Division, reading as follows:

"Reference is made to your memorandum of October 26, 1934, requesting a ruling in regard to whether the compensation received by Clarence M. Freedman, Philadelphia, Pennsylvania, in 1932 for services rendered to the Department of Banking of the Commonwealth of Pennsylvania in connection with the liquidation of banks taken over by that Department, is exempt from Federal income tax.

It appears that Mr. Freedman was appointed by the Department of Justice of the Commonwealth of Pennsylvania in 1932 at a salary of $3,000.00 as an attorney and assigned to do liquidation work in the Department of Banking. It is stated that each attorney so appointed is required to take an oath of office and is subject to the supervision of the special district attorney in charge of the bank to which the appointee is assigned and indirectly to the Attorney General of the state. It is stated that in some instances the salaries are assessed directly against the bank for which the work was done and in other instances they are paid from a gross assessment made against all banks in the area.

In order for the compensation received by an individual from a state or any political subdivision thereof to be exempt from Federal income tax it must be determined that it was received by him as an officer or employee of the state or political subdivision and that to subject it to Federal income tax would so burden the state or political subdivision as to constitute an interference through taxation by the Federal Government with the discharge by the state or political subdivision of an essential governmental function.

In G. C. M. 13488, I. R. B. XIII, 35, page 9, it is held that liquidators who are appointed to liquidate banks taken over by the state in Florida whose

compensation is paid from funds or assets of the bank being liquidated is subject to Federal income tax. In that decision it is stated:

> " . . . He was clearly not an officer of the State, and there is basis for the view that he was not an employee within the meaning of that term. If, however, it should be established that he was an employee of the State, it is certain that a tax upon his income cannot be deemed to be an interference with Government, or an impairment of the efficiency of its agencies in any substantial way. No such interference could result with respect to this taxpayer since the compensation was not paid by the State but by the bank which was being liquidated.
>
> In Miller v. McCaughn (22 Fed. (2d) 165), the United States District Court, in holding that the compensation received by an auditor appointed by the Pennsylvania State courts to report on the financial standing of corporations applying for approval as sureties on bonds, was not exempt from Federal income tax, stated:
>
> > " . . . The compensation must not merely come to a State officer or employee but it must come to him from the State to be exempt. Unless this second line is drawn and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the respondent might well be held to be such 'officer or employee' but in which the compensation does not come directly or indirectly from the State, otherwise

than in the sense that he would not be in the enjoyment of it, were it not for the relation of officer or employee of the State which he enjoys.

Here what the plaintiff receives comes wholly from the surety companies upon whose financial resources he reports. . . .''.

In view of the foregoing it is held that the compensation received by Mr. Freedman for services rendered to the Department of Banking of the Commonwealth of Pennsylvania must be included in gross income for Federal income tax purposes.''

The foregoing is all of the evidence material to the Assignment of Errors adduced at the hearing before the United States Board of Tax Appeals and the same is approved by the undersigned, as the attorneys for the respective parties to this proceeding.

(Sgd.) JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

(Sgd.) MORRISON SHAFROTH,
Attorney for Respondent on Review.

The foregoing is all of the evidence adduced at the hearing, which is material to the assignment of errors set forth in the petition for review filed by the petitioner herein, and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this sixteenth day of December, 1936.

(Sgd.) C. R. ARUNDELL,
Member, United States Board of Tax Appeals.

PRÆCIPE.

(Filed December 16, 1936.)

To the Clerk of the United States Board of Tax Appeals:

You are requested to prepare and transmit to the clerk of the United States Circuit Court of Appeals for the Third Circuit a certified copy of the record in the above-entitled case, including therein copies of the following:

1. Docket entries of the proceeding before the Board.

2. Pleadings before the Board:

(a) Petition, including annexed copy of deficiency letter and statement attached thereto;

(b) Answer.

3. Findings of fact and opinion of the Board promulgated August 19, 1936.

4. Decision or order of redetermination entered August 21, 1936.

5. Petition for review and assignment of errors.

6. Notice of filing petition for review and assignment of errors with proof of service of said notice and the said petition.

7. Statement of evidence.

8. This præcipe.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

Service of a copy of the foregoing præcipe is hereby acknowledged. Agreed to.

MORRISON SHAFROTH,
Attorney for Respondent on Review.

CERTIFICATE.

UNITED STATES BOARD OF TAX APPEALS,
WASHINGTON.

DOCKET No. 79424.

Clarence M. Freedman,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 50, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this thirtieth day of December, 1936.

B. D. GAMBLE,
(Seal) *Clerk, United States Board of Tax Appeals.*

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the Board of Tax Appeals

And now, to wit: This 28th day of April A. D. 1937, it is ordered that Hon. Oliver B. Dickinson, District Judge for the Eastern District of Pennsylvania, be and he is hereby assigned to sit in above case in order to make a full court.

JOSEPH BUFFINGTON, *Circuit Judge.*

(Endorsements:) Order Assigning Hon. Oliver B. Dickinson for Argument Received & Filed Apr. 28, 1937. William P. Rowland, Clerk.

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

And afterwards, to wit, the 28th day of April, 1937, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Joseph Buffington and Honorable John Biggs, Jr., Circuit Judges, and Honorable Oliver B. Dickinson, District Judge, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 23d day of August, 1937, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

In the United States Circuit Court of Appeals for the Third Circuit

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review From the United States Board of Tax Appeals

Opinion

Filed August 23, 1937

Before BUFFINGTON and BIGGS, Circuit Judges, and DICKINSON, District Judge

BUFFINGTON, J.: This is an appeal by the taxpayer from an order of the federal tax board assessing income tax against him, and the question involved is: "Was the annual salary of $3,000 received by petitioner in 1932 for services rendered as an attorney in the Department of Justice of the Commonwealth of Pennsylvania exempt from the Federal Income tax?" The facts, which are not in dispute, are thus stated by the Tax Board:

"The department of justice and the department of banking are administrative divisions of the Commonwealth of Pennsylvania. The head of the department of justice is the attorney general and the head of the department of banking is the secretary of banking, these offices being provided for by statute. The attorney general has statutory power 'to appoint and fix the compensation of Special Deputy Attorneys General and Special Attorneys to represent the Commonwealth, for any department, board, or commission thereof, in special work or in particular cases.' Purdon's Penna. Stats., title 71, Sec. 296. The secretary of banking is by statute given broad powers over banks within the commonwealth. When it appears to him that a bank is in an unsafe or unsound condition he may, after notice and hearing and with the consent of the attorney general, take possession of the business and property of the bank; under certain conditions he may take possession without hearing and without the attorney general's consent. When he takes possession of a bank, he is vested with 'all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonwealth;' while in possession of the bank he is 'the representative of the creditors thereof.' The banking law provides that, in the case of banks the property of which is in the possession of the secretary of banking, all expenses in connection with such possession and of continuing the business or of liquidation 'shall first be payable out of the funds of' such bank 'including the compensation of special deputies, assistants, and others employed by the Secretary to assist him in such proceed-

ings; the allowances of all such expenses to be subject to the approval of the Court.' Purdon's Penna. Stats., title 7, Sec. 29, 49.

"The petitioner was assigned to work under special deputy attorneys general in Philadelphia County in connection with legal matters pertaining to closed banks in that county. Such closed banks were being liquidated by the secretary of banking pursuant to statute. The petitioner's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the banking department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and 'in general anything that was assigned by the Special Deputy Attorney General at the time.' Such attorneys were considered by the department of justice as 'available for any purpose at any time.'

"The petitioner handled legal matters for the state banking department in connection with the liquidation of the Northern Central Trust Co., the Darby Bank & Trust Co., the United States Bank & Trust Co., the Central Trust & Savings Co., the Mortgage Security & Trust Co., the Park Trust Co., and the Wharton Trust Co., among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County.

"The particular work and the matters to which the petitioner gave attention were determined by the attorney general's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the attorney general's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the attorney general and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the attorney general.

* * * * * * *

"The petitioner received no compensation for his services other than his $3,000 salary, but was reimbursed for his expenses. He was furnished with necessary office facilities. He was required to use official letterheads furnished by the department of justice, and signed his letters as 'attorney' for the department of justice. The files in matters handled by him were considered the property of the state

and were turned over by him to his successor when his employment was terminated. While the department of justice could have required all his time and had first call on his services, he was permitted to engage in private practice. In 1932 he spent more than 50 percent of his time on state business. He had to give up certain regular employment to accept the employment in the department of justice. His professional income for 1932, aside from the $3,000 salary, was $2,735.60. He was not a member of a law firm.

"Petitioner's salary was paid to him semi-monthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the secretary of banking at Harrisburg."

The taxpayer paid income tax on the $2,735.60, his professional income. He claims his salary of $3,000 was exempt.

In pursuance of the statutory authority noted above, "to appoint and fix the compensation of Special Deputy Attorneys General and Special Attorneys to represent the Commonwealth, for any department, board, or commission thereof, in special work or in particular cases," the Attorney General of the State of Pennsylvania, on October 2, 1931, notified the taxpayer that "it gives me pleasure to appoint you an attorney in this Department assigned to the liquidation work of the Department of Banking. Your salary will be at the rate of $3,000.00 per annum. The Special Deputy Attorneys General who are assigned to this work in Philadelphia are being advised of your appointment and that you will be available to assist them in any way in which they may find it necessary to call upon you."

The uncontradicted testimony of the taxpayer was that "the Department of Banking had absolutely no authority over me. They did not instruct me as to what banks I was to work. The Attorney General did that. "The Deputy Attorney General testified: "It was considered that these men were available for any purpose at any time with the Department of Justice. They were controlled entirely by that department." In view of this uncontradicted evidence, we hold it proven that the taxpayer was an employee of the State acting by its Attorney General. Moreover, it will be noted that the Tax Board made no finding that he was not an employee of the State, but in that regard limited itself to the negative statement, "we are not satisfied that petitioner can properly be classified as an employee of the Commonwealth of Pennsylvania." Being an employee of the State or the Nation, being engaged in recognized governmental work—in this case the vital Department of Banking (Therrell v. Commissioner, 88 Fed. (2d) 869)—it follows that the quantum of the employee's pay, the means by which he is paid, are features which do not on the one hand determine the liability of the national employee to state taxes or the state employee to federal taxes. The Nation and the State, within their respective spheres of governmental administration, are not subject to taxation imposed by other sovereignties. Within their own province, they are

exempt from—to them—alien burdens in the way of taxation. Indian Motocycle Co. v. United States, 283 U. S. 570.

The same constitutional principle that prevents the State of Pennsylvania from taxing the income of special attorneys of the United States equally prevents the United States from taxing the income of special attorneys of the Commonwealth of Pennsylvania. As the national banks are "instrumentalities, means, and operations" whereby the Federal Government exercises a governmental control over them, so the state exercises like governmental control over state banks, for, as said in 283 U. S. 570, "this principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system."

So regarding, and without discussing the elaborate arguments and citations of the respective parties—all of which have been duly considered—we limit ourselves to setting aside the order of the Tax Board. This view is in line with the decisions of this Circuit in Commissioner v. Coughlin, 87 Fed. (2d) 670, and Commissioner v. Hindman, 88 Fed. (2d) 44.

A true Copy:
Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

In the United States Circuit Court of Appeals for the Third Circuit

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby reversed.

Philadelphia, August 23, 1937.

Per Curiam:

BUFFINGTON, *Circuit Judge.*

(Endorsements:) Order Reversing Decree Received & Filed Aug. 23, 1937. William P. Rowland, Clerk.

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, Third Judicial Circuit, Sct:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Transcript of Record and proceedings in this Court in the case of Clarence M. Freedman, petitioner, vs. Comr. of Internal Revenue, respondent, No. 6327, on file, and now remaining among the records of the said Court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 4th day of November, in the year of our Lord one thousand nine hundred and thirty-seven and of the Independence of the United States the one hundred and sixty-second.

WM. P. ROWLAND,
Clerk of the United States Circuit Court of Appeals, Third Circuit.

Supreme Court of the United States

Order allowing certiorari

Filed December 6, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following No. 287.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CLARENCE M. FREEDMAN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above cause on August 23, 1937, reversing the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 11–21) is reported in 34 B. T. A. 956. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 62) is reported in 92 F. (2d) 150.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 23, 1937 (R. 65). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether compensation received by one who renders services to a State is immune from Federal income taxation where the compensation is not paid out of the funds of the State.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 11–14.

STATEMENT

The facts in this case, as found by the Board of Tax Appeals (R. 11–16) are as follows:

The taxpayer is a lawyer, practicing his profession in Philadelphia, Pennsylvania (R. 11). On October 2, 1931, the Attorney General of the Commonwealth of Pennsylvania directed to the taxpayer a letter reading as follows (R. 12):

> It gives me pleasure to appoint you an attorney in this Department assigned to the liquidation work of the Department of Banking. Your salary will be at the rate of $3,000.00 per annum.
>
> The Special Deputy Attorneys General who are assigned to this work in Philadelphia are being advised of your appointment

and that you will be available to assist them in any way in which they may find it necessary to call upon you.

The taxpayer accepted the appointment conferred by the above letter. He was thereafter continuously employed on matters relating to the liquidation of closed banks, as hereinafter more fully related, until March 9, 1935, when his employment was terminated on the occasion of a change in the political party in control of the state government, whereupon he was directed to turn his files over to his successor. (R. 12.)

The Department of Justice and the Department of Banking are administrative divisions of the Commonwealth of Pennsylvania. The head of the Department of Justice is the Attorney General and the head of the Department of Banking is the Secretary of Banking, those offices being provided for by statute. The Attorney General has statutory power "to appoint and fix the compensation of special deputy attorneys general, and special attorneys, to represent the Commonwealth, or any department, board, or commission thereof, in special work or in particular cases." Purdon's Pennsylvania Statutes Annotated, Permanent Edition, Title 71, Section 296 (b). (R. 12.) The Secretary of Banking is by statute given broad powers over banks within the Commonwealth. When it appears to him that a bank is in an unsafe or unsound condition he may, after notice and hearing and with the consent of the Attorney General, take

possession of the business and property of the bank; under certain conditions he may take possession without hearing and without the Attorney General's consent. When he takes possession of a bank, he is vested with "all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonweath"; while in possession of the bank he is "the representative of the creditors" thereof. The banking law provides that, in the case of banks the property of which is in the possession of the Secretary of Banking, all expenses of such possession and of continuing the business or of liquidation "shall first be payable out of the funds of" such bank "including the compensation of special deputies, assistants, and others employed by the secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the court." Purdon's Pennsylvania Statutes Annotated, Permanent Edition, Title 7, Sections 29, 49. (R. 12–13.)

The taxpayer was assigned to work under special deputy attorneys general in Philadelphia County in connection with legal matters pertaining to closed banks in that county. Such closed banks were being liquidated by the Secretary of Banking pursuant to statute. The taxpayer's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the banking department that came up from

surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphan's Court, preparing data in connection with the proposed state banking code, and in general anything that was assigned by the Special Deputy Attorney General at the time. Attorneys such as the taxpayer were considered by the Department of Justice as "available for any purpose at any time." (R. 13–14.)

The taxpayer handled legal matters for the state banking department in connection with the liquidation of several closed banks in the Philadelphia area, and was one of approximately twenty lawyers assigned to like work in Philadelphia County (R. 14).

The particular work and the matters to which the taxpayer gave attention were determined by the Attorney General's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the Attorney General's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, his briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by

the Attorney General and his deputies. The taxpayer's advice to depositors of closed banks was limited to matters on which his superiors had ruled. Attorneys in the taxpayer's position were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the Attorney General. (R. 14.)

The taxpayer's duties and the manner in which they should be performed were prescribed in part by a large number of mimeographed circulars issued by the Attorney General at Harrisburg at frequent intervals and sent to all attorneys handling closed bank matters. Also, his instructions were received periodically from a Deputy Attorney General at regular meetings held for the purpose of discussing their problems and deciding on procedure. (R. 14–15.)

The taxpayer received no compensation for his services other than his $3,000 salary, but was reimbursed for his expenses. He was furnished with necessary office facilities. He was required to use official letterheads furnished by the Department of Justice, and signed his letters as "attorney" for the Department of Justice. The files in matters handled by him were considered the property of the State and were turned over by him to his successor when his employment was terminated. While the Department of Justice could have required all his time, and had first call on his services, he was permitted to engage in private practice. In 1932 he spent more than 50 per cent of his time

on state business. He had to give up certain regular employment to accept the employment in the Department of Justice. His professional income for 1932, aside from the $3,000 salary, was $2,735.60. He was not a member of a law firm. (R. 15.)

The taxpayer's salary was paid to him semi-monthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the Secretary of Banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks whose assets had been taken over by the Secretary of Banking, but later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the taxpayer's salary was charged were determined by the Attorney General and the Secretary of Banking. The salaries of attorneys handling matters relating to the several closed banks were ordinarily paid out of the funds of such banks in approximate proportion to the amount of work done for each bank. (R. 15.)

The taxpayer did not include in his income tax return for 1932 the $3,000 received as compensation for services rendered to the department of banking (R. 16). The Board of Tax Appeals held that this compensation was not immune from Federal taxation and was includable in the taxpayer's taxable income for 1932, and made an order

of deficiency (R. 17, 21). The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the taxpayer as a Special Deputy Attorney General of Pennsylvania was not subject to Federal income taxation.

2. In failing to hold that the taxpayer was neither an officer, an employee, nor an agent of the State, engaged in an essential governmental function of the State.

3. In failing to hold that even if the taxpayer were an officer, an employee, or an agent of the State, Federal taxation of the compensation received by him out of funds of insolvent state banks imposes no prohibited burden upon the State.

4. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below in the instant case is in direct conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *McLoughlin* v. *Commissioner,* 89 F. (2d) 699, No. 287, present term, certiorari granted, October 11, 1937. There it was held that the compensation of an attorney employed by the State of New York and engaged in the liquidation of insolvent

insurance companies was not immune from Federal income taxation for the reason that the compensation in that case was paid out of the funds of the companies liquidated. The decision below did not discuss the *McLoughlin* case nor did it discuss the fact largely relied on by the court in deciding that case, and which is present in this case, that the compensation of the taxpayer was paid wholly out of the property of the insolvent companies liquidated. The facts of the instant case and of the *McLoughlin* case are so similar that it cannot be doubted that the decision below directly conflicts with the conclusion of the Circuit Court of Appeals for the Second Circuit (89 F. (2d) 703):

> * * * we are persuaded that a liquidating agent paid wholly out of the property of an insolvent is not entitled to exemption.

The decision below is in accord with the decisions of the Circuit Court of Appeals for the Fifth Circuit in *Therrell* v. *Commissioner,* 88 F. (2d) 869, No. 128, present term, and *Tunnicliffe* v. *Commissioner,* 88 F. (2d) 873, No. 129, present term, certiorari granted in both on October 11, 1937. In the *Therrell* case the taxpayer was appointed liquidator of a number of banks in Florida. His compensation came from the funds of the banks being liquidated. The *Tunnicliffe* case involved similar facts. In both cases the decision of the Board of Tax Appeals, which had denied exemption from income taxation of this compensation, was reversed, one judge dissenting. The court in

the *McLoughlin* case, *supra,* expressed itself as obliged to differ with the decision of the majority in those two cases.

2. The precise question presented in *McLoughlin* v. *Commissioner, supra, Therrell* v. *Commissioner, supra, Tunnicliffe* v. *Commissioner, supra,* and the instant case, has never before been passed upon by this Court, and is of current administrative importance.

CONCLUSION

It is in the public interest that the conflict here presented be resolved by an authoritative decision.

Wherefore it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

NOVEMBER, 1937.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

Purdon's Pennsylvania Statutes, Annotated, Permanent Edition, Title 7:

SEC. 9. *Maintenance of department and assessment of expenses.*

(a) *Expenses*—All moneys derived by the department from fees, assessments, charges, penalties, and otherwise, shall be paid by the Secretary, through the Department of Revenue, into the State Treasury for safe-keeping and shall, by the State Treasurer, be placed in a separate fund, to be available for the use of the department upon requisition of the secretary. All such moneys so paid into the State Treasury are hereby specifically appropriated to the de-

partment for the purpose of paying the salaries of the secretary, the deputies, the examiners, and the other employes of the department, the expenses of the department,

* * *

The Auditor General shall, upon requisition of the secretary from time to time, draw warrants upon the State Treasurer for the amounts specified in such requisitions, not exceeding, however, the amount in such fund at the time of the making of any such requisition.

(b) *Assessments of Expenses upon Corporations and Individuals*—All the expenses incurred in and about the conduct of the business of the department, including the cost of the regular examinations of corporations and persons under the supervision of the department, the compensation of the secretary, deputies, examiners, and other employes of the department, together with all other general or overhead expenses of the department, shall be charged to and paid by the corporations and persons subject to the supervision of the department, in equitable proportions, at such times and in such manner, as the secretary shall by general rule or regulation annually prescribe:

* * * * *

On failure or refusal of any such corporation or person, after thirty days' written notice, to pay any sum lawfully assessed or charged against it or him by the secretary under the provisions of this clause, the secretary shall call upon the Department of Justice to bring an action at law to recover the same. (1923, June 15, P. L. 809, § 9; 1927, April 13, P. L. 182, § 1; 1929, April 25, P. L. 716, § 1.)

SEC. 49. *Expenses to be paid out of fund.* All assessments, charges, and penalties due to the department by such corporation or person, all expenses of the taking and maintaining possession of the business and property or the continuing of the business by the secretary, and all expenses of liquidation under the provisions of this act, shall first be payable out of the funds of such corporation or person, including the compensation of special deputies, assistants, and others employed by the secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the court. (1923, June 15, P. L. 809, § 49.)

Treasury Regulations 77:

ART. 56. *State contracts.*—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. Where warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and can not recover the full value of the warrants so returned, he may deduct from gross income for the year in which the warrants are converted into cash any loss sustained, and if he realizes more than the value of the warrants so returned he should include such amount in his gross income of the year in which realized.

ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in

connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary. * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1937

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CLARENCE M. FREEDMAN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 11–21) is reported in 34 B. T. A. 956. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 62–65) is reported in 92 F. (2d) 150.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Third Circuit was entered on August 23, 1937. (R. 65.) Petition for certiorari was filed on November 23, 1937, and was granted on Decem-

ber 6, 1937 (R. 66). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner's compensation as attorney in the Pennsylvania Department of Justice, paid to him by the Secretary of Banking out of the assets of insolvent banks in the course of liquidation, is subject to the Federal income tax.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 13–28.

STATEMENT

The facts in this case, as found by the Board of Tax Appeals (R. 11–16) are as follows:

The taxpayer is a lawyer, practicing his profession in Philadelphia, Pennsylvania. On October 2, 1931, the Attorney General of the Commonwealth of Pennsylvania directed to the taxpayer a letter reading as follows (R. 12):

> It gives me pleasure to appoint you an attorney in this Department assigned to the liquidation work of the Department of Banking. Your salary will be at the rate of $3,000.00 per annum.
>
> The Special Deputy Attorneys General who are assigned to this work in Philadelphia are being advised of your appointment and that you will be available to assist them

in any way in which they may find it necessary to call upon you.

The taxpayer accepted the appointment conferred by the above letter. He was thereafter continuously employed on matters relating to the liquidation of closed banks until March 9, 1935, when his employment was terminated on the occasion of a change in the political party in control of the state government. He was then directed to turn his files over to his successor. (R. 12.)

The Department of Justice and the Department of Banking are administrative divisions of the Commonwealth of Pennsylvania. The head of the Department of Justice is the Attorney General and the head of the Department of Banking is the Secretary of Banking, those offices being provided for by statute. The Attorney General has statutory power "to appoint and fix the compensation of special deputy attorneys general, and special attorneys, to represent the Commonwealth, or any department, board, or commission thereof, in special work or in particular cases." Purdon's Pennsylvania Statutes, Title 71, Section 296. The Secretary of Banking is by statute given broad powers over banks within the Commonwealth. When it appears to him that a bank is in an unsafe or unsound condition he may, after notice and hearing and with the consent of the Attorney General, take possession of the business and property of the bank; under certain conditions he may take posses-

sion without hearing and without the Attorney General's consent. When he takes possession of a bank, he is vested with "all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonwealth;" while in possession of the bank he is "the representative of the creditors" thereof. The banking law provides that, in the case of banks the property of which is in the possession of the Secretary of Banking, all expenses in connection with such possession, and of continuing the business or of liquidation, "shall first be payable out of the funds of" such bank "including the compensation of special deputies, assistants, and others employed by the secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the court." Purdon's Pennsylvania Statutes, Title 7, Sections 29, 49. (R. 12–13.)

The taxpayer was assigned to work under Special Deputy Attorneys General in Philadelphia County in connection with legal matters pertaining to closed banks in that county. The closed banks were being liquidated by the Secretary of Banking pursuant to statute. The taxpayer's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the banking department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders

of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and in general anything that was assigned by the Special Deputy Attorney General at the time. Such attorneys were considered by the Department of Justice as "available for any purpose at any time." (R. 13–14.).

The taxpayer handled legal matters for the state banking department in connection with the liquidation of the Northern Central Trust Company, the Darby Bank & Trust Company, the United States Bank & Trust Company, the Central Trust & Savings Company, the Mortgage Security & Trust Company, the Park Trust Company, and the Wharton Trust Company, among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County. (R. 14.)

The particular work and the matters to which the taxpayer gave attention were determined by the Attorney General's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the Attorney General's office as to preparation of documents and pleadings. His legal opinions

were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the Attorney General and his deputies. The taxpayer's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the Attorney General. (R. 14.)

The taxpayer's duties and the manner in which they should be performed were prescribed in part by a large number of mimeographed circulars issued by the Attorney General at Harrisburg at frequent intervals and sent to all attorneys handling closed bank matters. Also, his instructions were received periodically from a Deputy Attorney General at regular meetings held for the purpose of discussing their problems and deciding on procedure. (R. 14–15.)

The taxpayer received no compensation for his services other than his $3,000 salary, but was reimbursed for his expenses. He was furnished with necessary office facilities. He was required to use official letterheads furnished by the Department of Justice, and signed his letters as "attorney" for the Department of Justice. The files in matters handled by him were considered the property of the State and were turned over by him to his suc-

cessor when his employment was terminated. While the Department of Justice could have required all his time, and had first call on his services, he was permitted to engage in private practice. In 1932 he spent more than 50 per cent of his time on state business. He had to give up certain regular employment to accept the employment in the Department of Justice. His professional income for 1932, aside from the $3,000 salary, was $2,735.60. He was not a member of a law firm. (R. 15.)

The taxpayer's salary was paid to him semi-monthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the Secretary of Banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks the assets of which had been taken over by the Secretary of Banking, and later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the taxpayer's salary was charged were determined by the Attorney General and the Secretary of Banking. The salaries of attorneys handling matters relating to the several closed banks were ordinarily paid out of the funds of such banks in approximate proportion to the amount of work done for each bank. (R. 15.)

Taxpayer did not include in his income tax return for 1932 the $3,000 received as compensation for services rendered to the department of banking (R. 16). The Board of Tax Appeals held that this compensation was not immune from Federal taxation and was includable in the taxpayer's taxable income for 1932 (R. 21). The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals (R. 65).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the compensation received by the taxpayer as a Special Deputy Attorney General of Pennsylvania was not subject to Federal income taxation.

2. In failing to hold that the taxpayer was neither an officer, an employee, nor an agent of the State, engaged in an essential governmental function of the State.

3. In failing to hold that even if the taxpayer were an officer, an employee, or an agent of the State, Federal taxation of the compensation received by him out of funds of insolvent state banks imposes no prohibited burden upon the State.

4. In reversing the decision of the Board of Tax Appeals.

ARGUMENT

In the interests of brevity and to avoid needless repetition the arguments made under Points I and

II (pp. 11–35) in the brief for the petitioner in *Helvering* v. *Therrell*, No. 128, October Term, 1937, and in the brief (pp. 11–23) for the respondent in *McLoughlin* v. *Helvering*, No. 287, October Term, 1937, are adopted and incorporated herein by reference. The remaining discussion is directed only toward the particular provisions of the Pennsylvania statutes relating to the liquidation of closed banks.

I

THE SERVICES OF RESPONDENT WERE NOT IN CONNECTION WITH AN ESSENTIAL GOVERNMENTAL FUNCTION

In 1932, the Pennsylvania statutes[1] provided that the Secretary of Banking, after taking possession (Purdon's Statutes, Title 7, Sec. 21, *infra*), if he is not enjoined from continuing the proceeding (Sec. 23, *infra*), is vested with title to the assets of the corporation, has the status of a receiver, and is "the representative of the creditors" (Sec. 29, *infra*). He may either suspend business or continue to conduct it, pending his decision as to liquidation of the corporation (Sec. 27, *infra*). He has full powers to sue and is liable in the suits

[1] These provisions are summarized in the margin of this Court's opinion in *Pennsylvania* v. *Williams*, 294 U. S. 176, 182–184. They were repealed, after the taxable year, by Laws of 1933, No. 111, effective July 3, 1933, which provided a new Department of Banking Code, containing (Secs. 601–1014) more or less comparable provisions.

which were pending at the time he took possession, or for the recovery of specific property (Sec. 35, *infra*). After filing notice of a determination to liquidate (Sec. 41, *infra*), he is to file a partial or final account (Sec. 45, *infra*), and after confirmation by the court and distribution of funds (Sec. 46, *infra*), is discharged from liability (Sec. 47, *infra*).

Those who share in this distribution are the depositors and creditors (Sec. 45, *infra*). If a balance remains after paying their claims, the stockholders may elect, or, in their default the court may appoint, a liquidating trustee to take the place of the Secretary (Sec. 50, *infra*).

All expenses of the proceeding are to be paid out of the funds of the insolvent corporation (Sec. 49, *infra*). Indeed, the Secretary is authorized to surrender possession when there are no funds with which to continue the business or to liquidate it (Sec. 28, *infra*).

It is evident that in this case also the purpose of the proceeding is not to regulate the conduct of banking generally, but economically to conserve or to wind up the affairs of a particular business enterprise for the benefit of its creditors and stockholders. It follows that it is not an essential governmental function of the State and that the compensation of respondent may be taxed by the Federal Government.

II

A TAX ON COMPENSATION PAID FROM PRIVATE FUNDS CONTAINS NO THREAT TO THE DUAL SYSTEM OF GOVERNMENT

Sec. 49 of Purdon's Pennsylvania Statutes, Title 7, *infra,* provides that "all expenses of the taking and maintaining possession of the business and property or the continuing of the business by the secretary, and all expenses of liquidation under the provisions of this act, shall first be payable out of the funds of such corporation or person, including the compensation of special deputies, assistants, and others employed by the secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the court." The respondent's compensation was charged against the funds of three or four closed banks during the taxable year 1932. While the work was not wholly confined to these banks, the salaries of the attorneys assigned by the Attorney General to liquidation work in the Department of Banking were paid out of the funds of each closed bank in approximate proportion to the work done for each. (R. 15.) Respondent thus was paid from private rather than from state funds He was paid directly out of the particular banks with the affairs of which he was chiefly concerned. He is, therefore, to be contrasted with the subordinate employees of the Department of Banking who were engaged in regulatory, as opposed to liquidating activities. These employees were paid by the Treasurer of the State from the Department of

Banking fund," made up by assessments upon solvent banks. (R. 49–50, 53.) See Purdon's Statutes, Title 7, Section 9 (a), *infra*. Since the respondent was paid out of funds in which the State had no interest, but were being held for the sole benefit of depositors, creditors and stockholders of the insolvent banks, a Federal tax on this compensation contains no possibility of endangering our dual system. Such was the decision of this Court in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 174.

CONCLUSION

The tax in question is not forbidden by the implication of the Constitution, in that it is imposed (1) with respect to an activity which is not an essential governmental function and (2) on compensation derived from private rather than state funds. Either of these considerations is sufficient to support the determination of the Commissioner and the decision of the Board of Tax Appeals. The judgment of the court below should, therefore, be reversed.

Respectfully submitted.

STANLEY REED,
Solicitor General,
JAMES W. MORRIS,
Assistant Attorney General,
SEWALL KEY,
BERRYMAN GREEN,
Special Assistants to the Attorney General.
WARNER W. GARDNER,
Special Attorney.

DECEMBER, 1937.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Purdon's Pennsylvania Statutes, Annotated, Permanent Edition, Title 7:

SEC. 9. *Maintenance of department and assessment of expenses.*

(a) *Expenses.*—All moneys derived by the department from fees, assessments, charges, penalties, and otherwise, shall be paid by the Secretary, through the Department of Revenue, into the State Treasury for safe-keeping, and shall, by the State Treasurer, be placed in a separate fund, to be available for the use of the department upon requisition of the secretary. All such moneys so paid into the State Treasury, are hereby specifically appropriated to the department for the purpose of paying the salaries of the secretary, the deputies, the

examiners, and the other employes of the department, the expenses of the department; * * *

The Auditor General shall, upon requisition of the secretary from time to time, draw warrants upon the State Treasurer for the amounts specified in such requisitions, not exceeding, however, the amount in such fund at the time of the making of any such requisition.

(b) *Assessments of Expenses upon Corporations and Individuals*—All the expenses inourred in and about the conduct of the business of the department, including the cost of the regular examinations of corporations and persons under the supervision of the department, the compensation of the secretary, deputies, examiners, and other employes of the department, together with all other general or overhead expenses of the department, shall be charged to and paid by the corporations and persons subject to the supervision of the department, in equitable proportions, at such times and in such manner, as the secretary shall by general rule or regulation annually prescribe:

* * * * *

On failure or refusal of any such corporation or person, after thirty days' written notice, to pay any sum lawfully assessed or charged against it or him by the secretary under the provisions of this clause, the secretary shall call upon the Department of Justice to bring an action at law to recover the same.

Purdon's Pennsylvania Statutes, Title 7.

SEC. 19. *Jurisdiction of courts.*—Whenever it shall become the right or duty of the Attorney General to proceed against any

corporation or person under the supervision of the department, pursuant to the provisions of this act, he may, in his discretion, proceed either in the court of common pleas of Dauphin County or in the court of common pleas of the county where the banking house or other place of business of such corporation or person is located.

* * * * * *

SEC. 21. *Power of secretary to take possession.*—The secretary may, after hearing had upon notice given, with the approval and consent of the Attorney General, take possession of the business and property of any corporation or person subject to the supervision of the department, whenever it shall appear to him that such corporation or person:

I. Has violated any law regulating its or his business, and has persisted in such violation in disregard of an order duly made by the secretary;

II. Is conducting business in an unauthorized or unsafe manner and has persisted in disregard of an order duly made by the secretary;

III. Is in an unsafe or unsound condition to continue business: Provided, in such case, That the secretary may forthwith, without such hearing and consent of the Attorney General, take possession of the business and property of any such corporation or person receiving moneys on deposit, when and if, in his opinion the protection of depositors and the public requires such peremptory action;

IV. Has an impairment of capital, which has not been restored or made good within the time fixed by order of the secretary;

V. Has suspended payment of obligations.

VI. Has neglected or refused to comply with the terms of any lawfully issued order of the secretary;

VII. Has refused, upon proper demand, to submit the records and affairs of the business to the secretary, a deputy, or any duly authorized examiner or agent of the department;

VIII. Has refused to be examined upon oath or affirmation, regarding such affairs;

IX. Is in the hands of a receiver appointed by any court, or in any bankruptcy proceeding, or of an assignee or trustee for creditors appointed by such corporation or person.

The secretary may, in like manner, take possession of the business and property of any private or unincorporated bank, or the estate of any private banker, otherwise exempt from the supervision of the department, whenever such private or unincorporated bank shall have made an assignment for the benefit of creditors, or for any of the causes mentioned hereinbefore in this section.

SEC. 22. *Certificate of taking possession.*—When the secretary shall have duly taken possession of the business and property of a corporation or person as provided in section twenty-one of this act, he shall forthwith make, under his hand and official seal, a certificate setting forth that he has so taken possession, and shall file such certificate in his office, and cause a certified copy thereof to be filed in the office of the prothonotary, who shall index the same in the judgment index under the name of the corporation or person as defendant and the name of the secretary as plaintiff.

From and after the filing of such certified copy in the office of the prothonotary, the secretary shall supersede any receiver previously appointed by any court for, or any assignee or trustee for creditors appointed by, such corporation or person.

Such superseded receiver, assignee, or trustee shall forthwith file his account in the court having jurisdiction thereof, and pay over and deliver to the secretary all moneys, securities, assets, and property of such corporation or person in his custody, possession, or control. Said court shall allow credit for expenses and for the disbursements properly incurred or made prior to the taking possession by the secretary, and shall allow proper compensation to said receiver, assignee, or trustee, and his counsel, which, when determined, shall be paid out of the funds of said corporation or person in the hands of the secretary.

SEC. 23. *Injunction to restrain secretary.*—Whenever the secretary takes possession of the property and business of any corporation or person, such corporation or person may, at any time within ten days, apply to the court for an order requiring the secretary to show cause why he should not be enjoined from continuing such possession. The secretary may be served personally wherever found within the State, or by leaving a copy with the deputy in charge of his office, or by serving the special deputy appointed by him in such proceeding. At the hearing, a copy, certified by the secretary or one of his deputies, of any report of a duly instituted examination of such corporation or person shall be prima facie evidence of the facts therein stated; and if, from such report or reports or other evidence, there

shall appear to be just cause for the taking and continuing of possession by the secretary, he shall not be enjoined, unless such report or reports or other evidence shall be overcome by proper proof produced by such corporation or person, in which event the court shall direct the secretary to refrain from further proceedings and to surrender such possession.

SEC. 24. *Special agents and assistants.*—The secretary may, by the certificate of taking possession provided for in section twenty-two of this act, or by a subsequent certificate in like manner made and filed, appoint one or more special deputies as agent or agents to assist him in continuing or liquidating the business and affairs of any corporation or person in his possession. He may, from time to time, delegate to such special deputy or deputies such duties connected with such continuation or liquidation as he may deem proper. He may employ such expert assistants and legal counsel, and may retain such of the officers and employes of such corporation or person, as he may deem necessary in the continuation of the business or the liquidation and distribution of the assets. He shall require such security as he may deem proper from his agents and assistants appointed pursuant to the provisions of this section.

* * * * *

SEC. 27. *Suspension or continuation of business.*—The secretary is authorized, upon taking possession of the property and business of such corporation or person, to continue or suspend the business for such period as he may deem necessary to enable him to determine whether to liquidate the affairs of such corporation or person, and, during

such period, to take such action as in his judgment is necessary to conserve the assets and business.

SEC. 28. *Surrender of possession by secretary.*—The secretary may, upon conditions approved by him, surrender possession for the purpose of permitting such corporation or person to resume business to sell or convey its or his property and franchise, or to merge or consolidate its or his business with that of another corporation or person in accordance with the laws of this Commonwealth, or because he is without funds to continue or liquidate the business and property of which he has taken possession; but he shall not authorize any decrease of capital stock by a corporation except upon compliance by the corporation with the provisions of law as to such decrease.

Whenever the secretary shall surrender possession under the provisions of this section, he shall forthwith issue an order, under his official seal, authorizing such corporation or person to resume business, to sell or convey its or his property and franchises, or to merge or consolidate as aforesaid, and shall file said order in his office, and cause a certified copy thereof to be filed in the office of the prothonotary, who shall thereupon cause the entries upon the judgment index made pursuant to section twenty-two of his act to be satisfied.

SEC. 29. *Status and powers of secretary as receiver.*—Except as herein otherwise provided, the secretary shall, when he has taken possession of the business and property of a corporation or person, have all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonwealth; and he shall be vested, in his

official capacity, with all the rights, powers, and duties of such corporation or person and with all the property of such corporation or person, including debts due, liens, or securities therefor, and rights of action or redemption, whether or not the property of such corporation or person, including debts due, liens, or securities therefor, and rights of action or redemption, are held in the name of such corporation or person, or in the name of some other corporation or person, but actually the property of the corporation or person of which, or of whom, the secretary has possession.

He shall be the representative of the creditors of the corporation or person, and entitled, as such, to have vacated and set aside, for the benefit of the creditors, any judgment, execution, attachment, sequestration, payment, pledge, assignment, transfer, conveyance, or incumbrance, which could have been avoided by the creditors or any of them, or by which it is attempted to give any creditor unlawful preference over another.

He may, with leave of court obtained on petition after notice to all creditors of whom he has knowledge, surrender to the corporation or person any assets, including choses in action, whether the subject of pending proceedings or not, which are burdensome and of no advantage to creditors.

* * * * *

SEC. 31. *Continuance of possession; exceptions.*—When the secretary shall have duly taken possession of the business and property of corporation or person as provided in section twenty-one of this act, he shall hold such possession until the affairs

of such corporation or person have been liquidated by him, unless:

I. He shall have been directed by order of court to surrender such possession pursuant to the provisions of section twenty-three of this act,

II. He shall have permitted a resumption of business, or a sale or conveyance of property and franchises, or a merger or consolidation, pursuant to the provisions of section twenty-eight of this act,

III. The stockholders of such corporation, after payment of all creditors in full, shall have elected a trustee or trustees, to continue the liquidation of such corporation, or the court shall have appointed such trustee or trustees, pursuant to the provisions of section fifty of this act, and such trustee or trustees shall have duly qualified to take possession of the remaining assets of such corporation; or,

IV. The depositors and other creditors of such person and the expenses of such liquidation shall have been paid in full.

* * * * *

SEC. 35. *Actions and suits.*—For the purpose of executing any of the powers and performing any of the duties hereby conferred and imposed upon him, the secretary may, in the name of the corporation or person, prosecute and defend any and all actions and proceedings at law, in equity, or otherwise, pending at the time when the secretary takes possession of the business and property of such corporation or person.

He may, by bill of discovery or other legal or equitable proceeding, obtain information of, and sue for and recover, any assets, debts, or damages, which such corporation or person might sue for and recover, or which any

of the creditors might make available for the payment of their claims.

He may, at any time while he is in possession of the property and business of a corporation, institute and maintain against the directors, trustees, managers, or officers, any action or proceeding which is vested in such corporation or in the stockholders or creditors thereof.

He shall be liable to suit, in his representative capacity, by any person seeking to recover specific property, if such property could have been recovered as against the creditors of the corporation or person levying an execution thereon.

* * * * *

SEC. 41. *Notice to depositors and creditors.*—When the secretary shall have determined to liquidate the affairs of such corporation or person, he shall forthwith give written or printed notice to all depositors to produce to him their deposit or pass books for settlement, stating in such notice the amount which the books of the corporation or person show to be due to each depositor, subject to outstanding checks, and notifying such depositors that, unless a settlement of the deposit or pass books shall show a different amount to be due, or unless a depositor shall, within four months from the date of such notice, make proof, in the matter hereinafter set forth, that the amount due him differs from the amount as shown by the books of the corporation or person, the amount last mentioned will be conclusive as to the amount of the claim of such depositor, subject, as aforesaid, to any outstanding checks.

The secretary shall, at the same time, give written or printed notice to all creditors

other than depositors, so far as known to him, to make proof of their claims in the manner hereinafter set forth, within four months from the date of such notice, or be debarred from coming in upon the fund.

He shall also advertise such notices to depositors and other creditors in a newspaper, and in the legal newspaper, if any, designated by rules of court for publication of legal notices in said county, once a week for four successive weeks.

* * * * *

SEC. 45. *Partial or final account; objection.*—At the expiration of the time fixed by the notice and advertisement for the presentation of claims prescribed in section forty-one of this act, the secretary may file a partial or final account, consisting of a statement of receipts and expenditures, together with a list of the claims which have been allowed, and, separately, a list of the claims which have been objected to or are disputed, showing, as to all claimants, the names, addresses, and amounts.

If no account is filed within a year from the time when the secretary takes possession, any party interested may petition the court for an order on the secretary requiring the filing of an account.

Any account filed by the secretary shall be duly verified by him under oath or affirmation. Upon the filing thereof, he shall give written or printed notice, to all the depositors and other creditors known to him, of such filing, and that, unless objections shall be filed within thirty days from the date thereof, the same will be confirmed absolutely. He shall also, at the same time, advertise such notice in two newspapers once a week for four successive weeks.

During such period of thirty days, any depositor, other creditor, stockholder, or anyone having any interest, may file in the court objections in writing to said account or to the allowance of any of said claims, a copy of which objections shall forthwith be served upon the claimant whose claim is objected to, or his counsel, and upon the secretary, or his counsel, or the special deputy appointed by him in such proceeding.

SEC. 46. *Distribution.*—If, at the expiration of said period of thirty days from the filing of the account, no objections shall have been filed thereto, the same shall be confirmed absolutely. In case objections or exceptions are filed to any claim or claims, the account shall be confirmed absolutely as to those claims against which no objections or exceptions have been filed, and a partial or final dividend, as the case may be, shall be declared and paid by the secretary on all claims as to which no objections or exceptions have been filed. In case there shall be any disputed claim or any claim to which objections shall have been duly filed, the dividend shall be calculated as if all claims were valid and approved, and, after deducting and setting apart such portion of the dividend as may be declared on claims, in accordance with the priorities fixed by law, which are disputed or objected to, the balance shall be distributed among the other claims. If all or any of the claims disputed or objected to shall thereafter be determined to be valid, they shall then receive their portions of such dividends in accordance with the priorities fixed by law. If all or any of such claims be determined to be invalid, the portions of such dividend set apart for them shall be distributed to the valid claims.

SEC. 47. *Conclusiveness of confirmation and distribution; records; final destruction.*—The confirmation of a partial account and distribution thereunder, as aforesaid, shall be conclusive only as to the fund distributed, and shall not prevent the proof and allowance, out of the fund involved in any subsequent account, of claims not presented in time for allowance out of such previous fund.

The confirmation of a final account and distribution thereunder, after the objections thereto, if any, have been adjudicated as hereinafter provided, shall be conclusive; and shall work and effect a discharge of the secretary and all deputies or their sureties, from all liability in the matter; and the secretary or his successor, except as hereinafter provided in section fifty of this act, is authorized and empowered to destroy all records belonging to the corporation or person in his possession at the expiration of seven years from the date of the absolute confirmation of the final account of the secretary.

* * * * *

SEC. 49. * * * All assessments, charges, and penalties due to the department by such corporation or person, all expenses of the taking and maintaining possession of the business and property or the continuing of the business by the secretary, and all expenses of liquidation under the provisions of this act, shall first be payable out of the funds of such corporation or person, including the compensation of special deputies, assistants, and others employed by the secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the court.

SEC. 50. *Distribution of balance; liquidating trustees.*—If, after the filing and confirmation of the final account of the secretary, and the payment of all creditors in full, and the return to stockholders, who have paid to the secretary the amounts demanded pursuant to section thirty-seven of this act, of their pro rata shares of any such amounts not necessary to pay creditors in full, there shall remain a balance in the hands of the secretary, he shall call a meeting of the stockholders by serving written or printed notice upon them at least thirty days before the day fixed for the meeting.

At such meeting, the stockholders shall elect by ballot a trustee or trustees for the purpose of completing the liquidation. A majority of the stock present in person or by proxy shall be necessary to elect. Should the stockholders fail or refuse to elect, the secretary or any stockholder may petition the court for the appointment of such trustee or trustees, who, when appointed, shall give bond to the Commonwealth in such amount, with such surety, and on such conditions, as the court may direct.

When such trustee or trustees have been duly elected or appointed as aforesaid, the secretary shall then transfer, convey, and deliver to such trustee or trustees all the assets of the corporation then remaining in his hands. He shall thereupon be discharged from all further liability to such corporation and its creditors, and shall file a certified copy of the proceedings of said stockholders' meeting in his office, and cause a certified copy thereof to be filed in the office of the prothonotary. No powers subject to

the supervision of the department shall thereafter be exercised by such corporation, except by permission of the secretary, and after compliance by such corporation with all the requirements of law as to a new corporation desiring to exercise such powers.

Treasury Regulations 77:

ART. 56. *State contracts.*—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. Where warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and can not recover the full value of the warrants so returned, he may deduct from gross income for the year in which the warrants are converted into cash any loss sustained, and if he realizes more than the value of the warrants so returned he should include such amount in his gross income of the year in which realized.

ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State

or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary. * * *.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

CLARENCE M. FREEDMAN, *Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR RESPONDENT.

JOHN W. TOWNSEND,
National Press Bldg.,
Washington, D. C.
Attorney for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

CLARENCE M. FREEDMAN, *Respondent.*

MEMORANDUM FOR RESPONDENT.

Respondent does not oppose petitioner in his request that a writ of certiorari be granted herein.

The question involved is whether the annual salary of $3,000 received by respondent in 1932, for services rendered as an attorney in the Department of Justice of the Commonwealth of Pennsylvania, is exempt from the Federal income tax.

While respondent believes that the conclusion reached below by the Circuit Court of Appeals for the Third Circuit is correct, he agrees that the matter in controversy should be reviewed by this Court because, as stated in the petition, there is a conflict between the decision of the court below and that of the Circuit Court of Appeals for the Second Circuit in the case of *McLoughlin* v. *Commissioner*, 89 F. (2d) 699, No. 287, present term, certiorari granted October 11, 1937. The decision below, however, is in accord with the decisions of the Circuit Court of Appeals for the

Fifth Circuit in *Therrell* v. *Commissioner,* 88 F. (2d) 869, No. 128, present term, and *Tunnicliffe* v. *Commissioner,* 88 F. (2d) 873, No. 129, present term, certiorari granted in both on October 11, 1937.

In this case respondent was hired by the State performed services for the State, was responsible solely to State officials and had been promised an annual salary of $3,000 by the State. It follows, as a clear matter of law, that the legal obligation to pay the salary was solely that of the State itself. The petitioner contended below that the taxability of respondent's salary must be determined by an examination of the sources of the funds used by the State to discharge such legal obligation. This injects a test of exemption not heretofore sanctioned by any decision of this court, nor by any lower court prior to the decision in the *Therrell* case, *supra.*

Heretofore it has been considered that a person having the status of a government officer or employee, if engaged in carrying out usual governmental functions, is *per se* such an instrumentality of that government as to invoke the doctrine of reciprocal immunity. Since any change in the established principles will have far reaching consequences, and will vitally affect existing methods employed by the State of Pennsylvania in meeting the expenses of operating its Departments of Banking, Insurance, Highways, its Fish and Game Commissions, and other of its governmental activities, counsel for respondent ask for an opportunity to be heard in this case at the same time that arguments are submitted in the *Therrell* and *McLoughlin* cases, and consequently suggest that, if the writ be granted herein, this case be advanced and set for argument immediately following No. 287.

Respectfully submitted,

JOHN W. TOWNSEND,
National Press Bldg.,
Washington, D. C.
Attorney for Respondent.

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No. 597

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

CLARENCE M. FREEDMAN, *Respondent.*

BRIEF FOR THE RESPONDENT.

This case is before the Court on petition for certiorari to the United States Circuit Court of Appeals for the Third Circuit to review the judgment of that court reported in 92 F. (2d) 150, which reversed the decision of the United States Board of Tax Appeals reported in 34 B. T. A. 956.

The petition for the writ was granted December 6, 1937, and this case set for argument to follow *McLoughlin* v. *Commissioner,* No. 287, present term, here on writ of certiorari to the Circuit Court of Appeals for the Second Circuit, to review its judgment reported in 89 F. (2d) 699. The *McLoughlin* case is preceded on the argument list by *Commissioner* v. *Therrell,* No. 128, present term, and *Commis-*

sioner v. *Tunnicliffe*, No. 129, present term, both of which are here on writs of certiorari to the Circuit Court of Appeals for the Fifth Circuit, to review judgments of that court reported in 88 F. (2d) 869, and 88 F. (2d) 873, respectively. These several cases involve a similar question of Federal Constitutional law, the opinion in the *McLoughlin* case being in conflict with the opinion in the other three cases.

Question Involved.

Was the annual salary of $3,000 received by respondent in 1932 for services rendered as an attorney in the Department of Justice of the Commonwealth of Pennsylvania immune from Federal income taxation?

Statement of the Case.

On October 2, 1931, Freedman was appointed an attorney in the Department of Justice of the Commonwealth of Pennsylvania with a salary at the rate of $3,000 per annum, and was assigned to the liquidation work of the Department of Banking. In his 1932 income tax return he did not include such $3,000 salary in taxable income because "the Department of Justice in Pennsylvania had taken the matter up with the Commissioner of Internal Revenue in Washington and had secured a ruling which was submitted to all attorneys in the form of a memorandum to the effect that our salaries were not taxable" (R. 33). This ruling is set forth at R. 34-36. His return was examined by a Revenue Agent who advised that the salary was exempt (R. 33).

In his audit of the return the Commissioner included the salary in taxable net income on the ground that "state employees whose compensation is paid from funds of banks being liquidated are subject to Federal income tax (R. 7-8), and accordingly determined a deficiency in income tax against Freedman for the year 1932 in the amount of $142.70 (R. 5-9). From this determination he prosecuted an appeal to the Board of Tax Appeals (R. 3) which, after

a hearing, promulgated its findings of fact and opinion, holding petitioner's salary was taxable and affirming the Commissioner's determination (R. 11-21). The basic ground of the Board's decision denying petitioner's claim to immunity, as stated in its opinion, was that "the source of his income precludes any possibility of a burden on the State resulting from a tax" on his salary.

Freedman thereupon petitioned the Circuit Court of Appeals for the Third Circuit for a review of the Board's decision. That court reversed the Board, with an opinion (R. 62-65) in which it held:

> "Being an employee of the State or the Nation, being engaged in recognized governmental work—in this case the vital Department of Banking (Therrell v. Commissioner, 88 Fed. (2d) 869)—it follows that the quantum of the employee's pay, the means by which he is paid, are features which do not on the one hand determine the liability of the national employee to state taxes or the state employee to federal taxes. The Nation and the State, within their respective spheres of governmental administration, are not subject to taxation imposed by other sovereignties."

The Board made Findings of Fact which are very complete and fully supported by the evidence. These findings are set forth at R. 11-16 and are repeated in the Statement in the Commissioner's brief. They are not, therefore, restated here.

In his petition for the writ and in his brief the Commissioner specified four errors which appear to raise questions as to (1) whether Freedman was an employee of the State or an independent contractor, (2) whether his services were rendered in connection with a governmental function, and (3) whether the doctrine of reciprocal tax immunity is affected by considerations of how or where the State secured the funds with which to pay Freedman's salary. However, the Commissioner's argument is devoted exclusively to the two questions last stated. It may be in-

ferred, therefore, that in this Court, as in the court below, the Commissioner does not deny that Freedman was an "employee" of the State in the commonly accepted sense of that term.

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in the Appendix to the Commissioner's brief. The regulation which seems controlling on the precise question presented is Article 643 of Treasury Regulations 77, promulgated February 10, 1933, under the Revenue Act of 1932. That article provides:

> "Art. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable.
>
> An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary."

Summary of Argument

The index of the points covered by the argument, appearing at the front of this brief, will serve also as a summary of the argument presented on behalf of the respondent.

ARGUMENT.

The errors specified by the Commissioner in this case, as stated in his brief, are substantially the same as those specified by him in the *Therrell* and *Tunnicliffe* cases (Nos. 128 and 129, present term). Except that here he makes no specific argument that Freedman was not an employee of the State, the Commissioner's argument in this case is substantially the same as in those cases. His main discussion is contained in his brief in the *Therrell* case, and our argument will be directed primarily to answering the points there made.

Three independent questions are presented: (1) whether respondent was an employee of the Commonwealth of Pennsylvania; (2) whether respondent was employed in carrying out governmental functions of that State; and (3) whether respondent's claim to immunity from Federal income tax on his salary is affected by the fact that such compensation was paid out of the assets of closed banks, expropriated by the State to pay the expenses of liquidating those banks, and was not paid out of revenues derived by the State through general taxation.

At the outset it may be noted that the Commissioner in his brief in the *Therrell* case (p. 9) says that he is not asking for a re-examination of the cases which have established and applied the reciprocal tax immunity doctrine. Essentially, however, his argument is directed to the validity of the fundamental principles as stated in the decided cases, and which heretofore have been considered as so firmly fixed as to be unalterable except by amendment to the Federal Constitution. Clearly the Commissioner seeks to establish limitations on the immunity doctrine not heretofore recognized by the courts prior to the decision in the *McLoughlin* case now under review (No. 287, present term).

I. The Federal Government is without constitutional power to tax the compensation of an officer, employee or other instrumentality employed by the state to carry out appropriate governmental functions, and the source of the funds used by the state to discharge its obligation to pay such compensation is immaterial.

The principal trouble with the Commissioner's argument is the failure to recognize fundamental principles of constitutional law. A due recognition of those well-established principles makes the solution of the problem here comparatively easy. We feel, therefore, that it is desirable to review certain of the cases in which the doctrine of immunity has been given effect, even though this may considerably lengthen our brief.

1. *For almost a century it has been recognized that tax immunity extends to fixed salaries and compensation paid to governmental officers and employees in their capacity as such.*

The Commissioner's brief in the *Therrell* case proceeds on the theory that the Federal Government does have Constitutional jurisdiction to tax the salary of a State employee and that whether it may exercise such jurisdiction depends upon whether, in a particular case, there has been a showing of some positive burden on or interference with the carrying out of a governmental function by the State. While in the decided cases *one reason* assigned by this Court in support of the immunity doctrine has been the possibility or actuality of some burden, financial or otherwise, in a given case, the *fundamental reason* for this doctrine is the inherent lack of Constitutional power in the Federal Government to invade the field of governmental powers reserved to the States, on the one hand, and the lack of similar power in the State to invade the field of governmental powers delegated to the National Government. The very existence of the unique form of our dual constitutional government, operating in the same territorial jurisdiction, requires strict adherence to principles which preclude one

government from asserting its taxing power upon any appropriate means adopted by the other government to carry out its constitutional functions in its particular sphere of operations.

It is thus upon the basis of this lack of Constitutional power over the subject matter that the one government is denied the right to tax the governmental instrumentalities of the other. *The essence of the rule is lack of jurisdiction to lay a tax.* The situation is the same as though the officer, employee or other governmental agency were without the territorial jurisdiction of the government attempting to lay the tax.

The foregoing principles appear clearly established by the many decisions of this Court which consider the application of the immunity rule, both in the field of taxation and in other fields. Within the month the Court has carefully considered and reviewed many of them in the important case of *James* v. *Dravo Contracting Company,* No. 3, present term. For this reason no attempt will here be made to analyze any of the cases except those bearing *directly* on the question of immunity of governmental officers and employees.

Before proceeding to a brief analysis of those few cases, however, it may be observed that a careful examination of the decisions dealing with tax immunity discloses that the principal difficulty in particular cases has been that of differentiating between what are government agencies and instrumentalities, and what are not. No case has been found where a tax has been upheld upon an agency of either the State or Federal Governments, which was admitted or found to be carrying out essential government functions. For this reason the Court has met no difficulty in those cases where an officer or employee was involved, for such agencies are everywhere conceded of necessity to be agents or instrumentalities of the government for which they work. Government must function through persons. Only through the services of persons can the government serve its citizens. That is axiomatic. Hence the cases which have given rise to problems difficult of solution have been those where

no direct employer-employee relationship is shown. Such cases are those where the person or agency involved was so independent of government as to have freedom of action in functioning, and where the work to be performed was prescribed primarily by contract and not by statutes or by regulations and edicts predicated upon statutory authority.

While the immunity principle in relation to officers and employees (conceded or proven to be such) is adverted to in many cases it has been applied to such governmental agencies in but four cases decided by this court.

Dobbins v. *Commissioners,* 16 Pet. 435 (1842), held that a State cannot tax an officer of the United States, for his office, or its emoluments. Dobbins was a captain in the United States revenue-cutter service, stationed at Erie, Pennsylvania, and the tax was a county tax assessed upon "all offices and posts of profit, professions, trades, and occupations, having a due regard to the profits arising therefrom". In the Commissioner's brief (pp. 18-19) in the *McLoughlin* case, the Solicitor General appears to ignore the principal ground assigned by the Court for its conclusion in the *Dobbins* case, *i. e.*, the lack of power in one government to interfere with the constitutional means employed by the other government. He refers to two other grounds there stated, which appear to deal merely with financial burden, in the one case on the State itself and in the other on the employee. He asserts that the latter of these two grounds has been overruled in the *Dravo* decision. We do not believe that there is anything in the *Dravo* case (which dealt with an admitted non-governmental instrumentality) that is inconsistent even with the reasoning in the *Dobbins* case (which dealt with an admitted governmental instrumentality). Certainly the main ground stated in the *Dobbins* opinion has not been overruled but, on the contrary, strongly reaffirmed. Both because it is necessary to correct the Commissioner's statement of this Court's reasons for the *Dobbins* decision, and because the language of the Court there is so appropriate to the proposed tax on Freedmen's salary, it is quoted somewhat at length. After pointing out at pages 445-446 that:

"*The emoluments of the office, then, are taxable, and not the office.* But, whether it be one or the other, we cannot perceive how a tax upon either conduces to comprehend within the terms of the act, the office or the compensation of an officer of the United States. It will not do to say, as it was said in argument, that though the language of the act may import that offices and posts of profit were taxable, that it was the citizen who holds the office whom the law intended to tax, and that it was a burden he was bound to bear in return for the privileges enjoyed, and the protection received from government; and, then, that the liability to pay the tax was a personal charge, because the person upon whom it was assessed was a taxable person.

The first answer to be given to these suggestions, is, that the tax is to be levied upon a valuation of the income of the office.

* * *

Taxes are never assessed, unless it be a capitation tax, upon persons as persons, but upon them on account of their goods, and the profits made upon professions, trades, and occupations."

the Court held:

"Taxation is a sacred right, essential to the existence of government; an incident of sovereignty. The right of legislation is coextensive with the incident, to attach it upon all persons and property within the jurisdiction of a State. But in our system there are limitations upon that right. There is a concurrent right of legislation in the States and the United States, except as both are restrained by the constitution of the United States. Both are restrained upon this subject, by express prohibitions in the constitution; and the States, by such as are necessarily implied when the exercise of the right by a State conflicts with the perfect execution of another sovereign power, delegated to the United States. *That occurs when taxation by a State acts upon the instruments, emoluments, and persons which the United States may use and employ as necessary and proper means to execute their sovereign powers.*

* * *

But the unconstitutionality of such taxation by a State as that now before us may be safely put—*though it is not the only ground—upon its interference with the constitutional means* which have been legislated by the government of the United States to carry into effect its powers to lay and collect taxes, duties, imposts, etc., and to regulate commerce. In our view, it presents a case of as strong interference as was presented by the tax imposed by Maryland, in the case of M'Culloch, 4 Wheat. 316; and the tax by the City Council of Charleston, in Weston's Case, 2 Pet. 449; in both of which it was decided by this court, that *the state governments cannot lay a tax upon the constitutional means employed by the government of the Union to execute its constitutional powers.*

But we have said that the ground upon which we have just put the unconstitutionality of the tax in the case before us, is not the sole ground upon which our conclusion can be maintained. *We will now state another ground;* and we do so *because it is applicable to exempt the salaries of all officers of the United States from taxation by the States.*

The powers of the national government can only be executed by officers whose services must be compensated by congress. The allowance is in its discretion. *The presumption is that the compensation given by law is no more than the services are worth,* and only such an amount as will secure from the officer the diligent performance of his duties. 'The officers execute their offices for the public good. This implies their right of reaping from thence the recompense the services they may render may deserve;' without that recompense being in any way lessened, except by the sovereign power from whom the officer derives his appointment, or by another sovereign power to whom the first has delegated the right of taxation over all the objects of taxation, in common with itself, for the benefit of both. And no diminution in the recompense of an officer is just and lawful, unless it be prospective, or by way of taxation by the sovereignty who has a power to impose it; and which is intended to bear equally upon all according to their estate.

The compensation of an officer of the United States is fixed by a law made by congress. It is in its exclu-

sive discretion to determine what shall be given. It exercises the discretion and fixes the amount, and confers upon the officer the right to receive it when it has been earned. *Does not a tax, then, by a State upon the office, diminishing the recompense, conflict with the law of the United States, which secures it to the officer in its entireness?* It certainly has such an effect; and any law of a State imposing such a tax cannot be constitutional, because it conflicts with a law of congress made in pursuance of the constitution, and which makes it the supreme law of the land."

The doctrine was next applied in the case of *Collector* v. *Day*, 11 Wall. 113, (1870) where it was established to be a reciprocal rule. Day was a county probate judge in Massachusetts. The Court held the Federal income tax provided in the Act of 1864 invalid as applied to his official salary. The Court said the same considerations which require the compensation of a Federal official to be held exempt require that of a State official to be immune, and approved the reasoning of the *Dobbins* case, saying:

"In *Dobbins* v. *The Commissioners of Erie County*, it was decided that it was not competent for the legislature of a State to levy a tax upon the salary or emoluments of an officer of the United States. *The decision was placed mainly upon the ground that the officer was a means or instrumentality employed for carrying into effect some of the legitimate powers of the government, which could not be interfered with by taxation or otherwise* by the States, and that the salary or compensation for the service of the officer was inseparably connected with the office; that if the officer, as such, was exempt, the salary assigned for his support or maintenance while holding the office was also, for like reasons, equally exempt."

The next cases involving compensation for personal services rendered were *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514 (1925) and *Helvering* v. *Powers*, 293 U. S. 214 (1934). Both cases seem to have been decided on the ground that the taxpayer was not a true governmental instrumentality—in the *Metcalf & Eddy* case because there was an indepen-

dent contractor status, and in the *Powers* case because he was not carrying out usual governmental functions.

Then came *New York ex rel. Rogers* v. *Graves*, 299 U. S. 401 (1937), where the New York income tax was held invalid as applied to the salary of the General Counsel of the Panama Railroad Company, a corporation which the Court held to be a Federal instrumentality carrying out appropriate governmental functions. The reasons for the immunity rule were not discussed but the previously established rule was accepted without question and applied, the Court holding:

> "The railroad company being immune from state taxation, it necessarily results that fixed salaries and compensation paid to its officers and employees in their capacity as such are likewise immune."

The most recent case squarely in point is *Brush* v. *Commissioner*, 300 U. S. 352 (decided March 15, 1937). Brush was Chief Engineer of the Bureau of Water Supply of the City of New York. The Court held the Federal Government could not lay an income tax on his official salary. The only question discussed was whether he was engaged in a governmental function, and was thus a governmental instrumentality. Holding that he was so employed, the Court said it necessarily followed that his salary was exempt from tax because "fixed salaries and compensation paid to its (the municipality's) officers and employees in their capacity as such" are immune.

2. *The recent decision in James* v. *Dravo Contracting Co. unanimously states and reaffirms the basic principle applied in previous cases.*

In that case the Court held a State could collect a tax laid upon the gross receipts of a corporation under contracts with the United States, where an independent contractor relationship resulted from such contracts. The Court was careful to point out that:

"The tax is not laid upon the Government, its property or officers. *Dobbins* v. *Commissioners,* 16 Pet. 435, 449, 450.

The tax is not laid upon an instrumentality of the Government. *McCulloch* v. *Maryland,* 4 Wheat. 316; *Osborn* v. *The Bank of the United States,* 9 Wheat. 738; *Gillespie* v. *Oklahoma,* 257 U. S. 501; *Federal Land Bank* v. *Crosland,* 261 U. S. 374; *Clallam County* v. *United States,* 263 U. S. 341; *New York ex rel. Rogers* v. *Graves,* 299 U. S. 401. Respondent is an independent contractor."

That governmental officers, employees and other direct instrumentalities are Constitutionally immune seems to be the position of all nine Justices of this Court. This appears not only from the above quotation from the opinion of Mr. Chief Justice Hughes, concurred in by four Justices, but from other statements he makes. It is emphasized by the analysis of the decisions in *Telegraph Company* v. *Texas,* 105 U. S. 460, *Leloup* v. *Port of Mobile,* 127 U. S. 640, and *Williams* v. *Talladega,* 226 U. S. 404. The Court pointed out that in those cases the independent contractor had been considered as the *agent* of the government to conduct essential public business It thus appears that even an independent contractor, if especially constituted an instrumentality to carry out governmental functions, may be entitled to tax immunity on the payments received pursuant to such an agency arrangement.

That the decision in the *Dravo* case specifically supports the respondent's contentions in this case is further evident when we consider the views expressd by Mr. Justice Roberts and the three other Justices who joined with him in the dissent. As the very basis of that dissent they reaffirm the principles contended for by respondent here, saying:

"The doctrine which forbids a state to interfere with the exercise of federal powers does not have its origin in the common law exemption of the sovereign from regulation or taxation. It springs from the necessity of maintaining our dual system of government. 'The at-

> tempt to use it (the power of taxation) on the means employed by the government of the Union, in pursuance of the constitution, is itself an abuse, because it is the usurpation of a power which the people of a single State cannot give. We find, then, on just theory, a total failure of this original right (of the states) to tax the means employed by the government of the Union, for the execution of its powers.' 'The immunity is derived from the Constitution in the same sense and upon the same principle that it would be if expressed in so many words.'
>
> * * *
>
> *In its application the principle forbids taxation by a state of property of the federal government, or of the office or salary of any of its officers.''*

Mr. Justice Roberts, after pointing out that "admittedly the appellee is not an agency or instrumentality of the United States," proceeds to considerations favorable to extending immunity in that case to such an admitted non-governmental agency. Thus the full Court seems to have concurred in the view that in all events a tax cannot be laid upon a governmental officer or on his salary, solely because he is such an instrumentality of the one government that the other is without Constitutional power to lay the tax. Mr. Justice Roberts in his opinion also said:

> "Chief Justice Marshall denied the existence of the power. From that day to this the court has consistently held that the question is not one of quantum, not one of the weight of the burden, but one of power."

In the *Dravo* decision, the Court emphasized that the earnings of the independent contractor do not stand "upon the same footing as interest upon governmental securities or the income of an instrumentality of government," pointing out that it was so held in *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514. With further reference to that case Mr. Chief Justice Hughes said:

> "The reasoning upon which that decision was based is controlling here. We recognized that in a broad sense

'the burden of federal taxation necessarily sets an ecomic limit to the practical operation of the taxing power of the States and *vice versa.*' *'Taxation by either the state or the federal government affects in some measure the cost of operation of the other.'* As 'neither government may destroy the other, *or control in any substantial manner the exercise of its powers,'* we said that the limitation upon the taxing power of each, so far as it affects the other, 'must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax . . . or the appropriate exercise of the functions of the government affected by it.' *Metcalf & Eddy* v. *Mitchell, supra,* pp. 523, 524.

We said further that the nature of the governmental agencies or the mode of their constitution could not be disregarded in passing on the question of tax exemption, as it was obvious that *an agency might be of such a character or so intimately connected with the exercise of a power or the performance of a duty by the one government 'that any taxation of it by the other would be such a direct interference with the functions of government itself as to be plainly beyond the taxing power.' And it was on that principle that 'any taxation by one government of the salary of an officer of the other, or the public securities of the other, or an agency created and controlled by the other, exclusively to enable it to perform a governmental function,' was prohibited.* We concluded that a non-discriminatory tax upon the earnings of an independent contractor derived from services rendered to the Government could not be said to be imposed 'upon an agency of government in any technical sense' and could not 'be deemed to be an interference with government or any impairment of the efficiency of its agencies in any substantial way.' Id. pp. 524, 525."

The pith of the decision in the *Dravo* case seems to be that tax immunity may not generally be extended to the independent contractor, for he is not *per se* an instrumentality of government, but must always be extended to—

> "taxation by one government of the salary of an officer of the other, or the public securities of the other, or an agency created and controlled by the other, exclusively to enable it to perform a governmental function."

Read together, accepting both their *statement* of the rule, and the reasons asigned therefor, *Dobbins* v. *Commissioner*, *Collector* v. *Day*, *Rogers* v. *Graves*, *Brush* v. *Commissioner*, *Metcalf & Eddy* v. *Mitchell* and *James* v. *Dravo Contracting Company*, establish the principles that a governmental officer or employee is *per se* an instrumentality of the sovereign which employes him and, if engaged in carrying out functions appropriate to government, his compensation is immune solely because neither a State nor the Federal Government has Constitutional power to tax a governmental agency or instrumentality of the other government. The two last mentioned cases seem to establish the reverse principle that an independent contractor is not *per se* an instrumentality of government, and hence a tax on his compensation is generally to be held valid.

In the *Dravo* case the Court has thus again approved and applied the test long applied by the lower courts, the Board of Tax Appeals and the Treasury Department itself in cases like the present—namely, is the taxpayer an officer or employee, or is he an independent contractor? It is a practical test, and one which the courts and the Board have found no great difficulty in applying. The principles for distinguishing officers and employees from independent contractors have become fairly well settled. The reaffirmance of the validity of this test of immunity should serve to eliminate much litigation in the field of Federal taxation.

The foregoing cases are so consistent, so explicit and so squarely in point (assuming, as we do for this part of our brief, that Freedman was a State employee engaged in carrying out governmental functions) that there would seem to be little room for argument left.

3. *The Commissioner's contention that the source of the funds used by the State to pay its employee's compensation limits the right to immunity, has never received the sanction of this Court, and is inconsistent with both the statement of and reasons for the immunity doctrine.*

Clearly, aside from the decision of the Circuit Court in the *McLoughlin* case, the contention of the Commissioner has never received judicial sanction. This Court has never suggested any such limitation on the immunity principle. In fact in both the *Rogers* and *Brush* cases the compensation was not paid out of funds raised by taxation. Rogers was paid out of earnings of a railroad, and Brush out of charges for water furnished, but such facts were not considered to affect their right to immunity as governmental instrumentalities. Indeed, until recently both the Treasury Department and the Board of Tax Appeals have never considered the source of the compensation to be material in determining the right to exemption from the Federal income tax. This is shown in Point II of the Brief for the Petitioner in the *Therrell* case (No. 287, present term). Furthermore, there have been a considerable number of court decisions involving officials who were not paid directly by the State or a political subdivision thereof and who have been held exempt from Federal income tax. See the analysis of such cases at page 30 of that same brief.

Not only is the Commissioner's contention without judicial sanction but we believe the rule for which he contends is wholly inconsistent with the very reasons for the immunity doctrine. Certainly this Court in all its *statements of the rule* has never referred to any such limitation that the source of the funds affected the right to immunity.

Let us analyze the Commissioner's contention in light of the principles established by the cases already reviewed. *In essence, it must be that the Commissioner asserts that a State officer or employee ceases to be an officer or employee, and thus ceases to be a State instrumentality of govern-*

ment, when his compensation is paid in any way other than out of funds raised by general taxation. This must be so for, as heretofore shown, the very basis for the immunity doctrine is lack of jurisdiction in the Federal Government to tax a State agency. The only way to avoid the application of the rule and to secure authority for the tax is to establish that the person is not a State instrumentality. We thus come to an examination of whether the source of the compensation in any way affects the status of the officer or employee as an instrumentality of his State government.

4. *The source of the State employee's compensation cannot affect his status as an agency or instrumentality of the State Government.*

It seems proper to note that the Commissioner's assertion that Freedman was "paid from private funds" is misleading. The Commissioner's entire argument in his brief in the *Therrell* case is predicated upon the assumption that the taxpayer's compensation was "paid out of private funds" (p. 35). This, however, is but a half-truth and consequently the argument built on such a premise necessarily leads to invalid conclusions. The whole truth is that the taxpayer's compensation was paid out of private funds *expropriated by the sovereign and applied to the use of the sovereign.* The Commissioner appears to have shut his eyes to the fact that all of the costs of government are paid out of private funds. The source of all governmental revenues and of all the funds used by the sovereign to discharge its obligations are necessarily basically "private funds". So a solution to the problem is in nowise aided by starting with the assumption that the source of the compensation is "private funds". Since all governmental expenses are necessarily paid out of private funds commandeered by the sovereign, the argument of the Commissioner amounts to no more than the suggestion that the *method* by which the sovereign obtains the funds with which to discharge its ob-

ligations has some bearing upon the Constitutional question presented. We respectfully submit, however, that the *method* by which the sovereign obtains the particular moneys with which to pay a particular officer or employee has no relevancy whatever to the problem at hand.

To say that Freedman was not in legal effect paid by the State would be to ignore settled principles of constructive receipt. If A owes B money for services rendered by B to A, and if B permits or requires A to pay the salary of one of B's employees, certainly B is considered to have constructively received the money and to be liable for an income tax thereon. Compare *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716. No one would argue that the servant was not paid by B, his own employer. So if there is here any room for the contention that the salary was in fact paid out of the assets of the banks,* it would be immaterial, since in legal effect the situation is the same as though the State's charges for supervising the liquidation proceedings were paid by the banks into the State Treasury, the funds commingled with other revenues, and then paid out in salaries to Freedman and other State employees. In all events the State constructively received the funds used to pay the salary, and in contemplation of law the salary was paid out of funds of the State itself.

The sovereign (whether the Federal Government or a State Government) assuredly may enter into any sort of arrangement it chooses with an officer or employee concerning the amount of compensation and the method of payment. Also there is concededly no limitation on the right of the sovereign to choose the method to be used in obtaining the funds with which to pay the promised com-

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*The Board found (R. 15):

> "Petitioner's salary was paid to him semimonthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the secretary of banking at Harrisburg."

pensation. It may pay that salary out of revenues derived through various forms of taxation; it may pay the salary out of fees prescribed for special services and paid into the State treasury; or, as in this case, it may under its broad sovereign powers simply expropriate certain private property in fulfillment of its obligation to compensate the employee for the services rendered to the State. In all such cases it exercises sovereign powers to take over private funds from its citizens to pay public officers and employees.

In early times the judges of England were paid by fees upon the volume of business transacted by them.* In our country not more than half a century ago the fees of United States attorneys deducted from the collection of customs due in litigation, and retained in lieu of salaries, became so large that Congress changed the method of compensation from the fee basis to the annual fixed salary basis.

With these historic precedents in mind, and the countless others of a similar nature that could be cited, how can it be said in this day that the incumbent of an office, paid out of fees, is not an officer of government merely because he is not paid directly out of the treasury of the Crown, of the United States Government or of the State? Is it not a necessary part of the freedom of the sovereign that it may select the method of compensation? It may be that in some cases the fee basis of compensation leads to abuse, in others it may be the most convenient way to reduce the general burden on taxpayers—that is beside the point. The point is that the sovereign must be free, without interference of any kind to choose its means or instrumentalities. That is why the Court said long ago that a tax on the salary of an officer is a tax on the office itself (*Macallen* v. *Mass.*, 279 U. S. 620, 626, citing *Dobbins* v. *Erie County, supra*).

An important consideration to keep in mind is that the

Scott v. *Avery*, 25 L. J. (Exch.) 308, 312, 313; see also, Cohen, Commercial Arbitration and the Law, Chapter XIX, pages 254-256.

collection of fees from those to whom the service is rendered is, in its very nature, a charge for services rendered by government, as was pointed out in the following paragraph from Mr. Justice Sutherland's opinion in the *Brush* case:

> "And to say that, because the city makes a charge for furnishing water to private consumers, it follows that the operation of the water works is corporate and not governmental, is to beg the question. *What the city is engaged in doing in that respect is rather rendering a service than selling a commodity. If that service be governmental it does not become private because a charge is made for it, or a profit realized.* A state, for example, constructs and operates a highway. It may, if it choose, exact compensation for its use from those who travel over it (see *Bingaman* v. *Golden Eagle Lines*, 297 U. S. 626, 628); but this does not destroy the claim that the maintenance of the highway is a public and governmental function. The state or the city may exact a tuition charge for instruction in the public schools; but thereby the maintenance of the public schools does not cease to be a function of the government. *The state exacts a fee for issuing a license or granting a permit; for recording a deed; for rendering a variety of services in the judicial department. Do these various services thereby lose their character as governmental functions?* The federal Post-Office Department charges for its services; but no one would question the fact that its operation calls into exercise a governmental function." 300 U. S. 352, 372.

Most important in this case are the facts that respondent was engaged by the State, promised a salary by the State, rendered services to the State, and that the legal obligation to pay the salary was that of the State. Much of the Commissioner's argument is invalid because of failure to give due recognition to such all-controlling facts.

Respondent was not employed by the closed banks; the banks had nothing to do with his selection nor with the terms of his employment. Hence the State, acting through its Attorney General who acted pursuant to statutory au-

thority "to appoint and fix the compensation * * * of Special Attorneys to represent the Commonwealth" (R. 12), in writing employed respondent as "an attorney in this Department" at a salary "at the rate of $3000.00 per annum" (R. 12). Hence he was engaged by the State and promised a fixed salary by the State itself. The Commissioner's argument seems to ignore these facts. The claim is that respondent was paid out of "private funds". The Board found, however, that (R. 15):

> "Petitioner's salary was paid to him semimonthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the secretary of banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks whose assets had been taken over by the secretary of banking, but later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the petitioner's salary was charged were determined by the attorney general and the secretary of banking. The salaries of attorneys handling matters relating to the several closed banks were ordinarily paid out of the funds of such banks in approximate proportion to the amount of work done for each bank."

In this case, therefore, we do not have a situation where a public servant renders a direct service to a private person or corporation. Here it was the State which had exercised its sovereign power to take over the banks and supervise their orderly liquidation in the public interests. *Respondent was but an instrumentality of the State in rendering that public service.* The State itself, and not Freedman, rendered the service to the closed banks.

Thus respondent's salary was actually paid by the State out of moneys legally in its possession. How it got the funds seems wholly immaterial *as the legal obligation to pay the salary was clearly that of the State.* From respondent's

standpoint, and from the standpoint of this case, it matters not what accounting the State might have made to the banks. It took physical possession of the private funds and expropriated the same for the purpose of paying obligations incurred by the State in its own name and for its own public purposes.

Here the State undertook to liquidate the assets of the banks. The legislature could have defrayed the expenses of the State out of the general funds in its Treasury, or out of prescribed fees charged for particular services, or out of the funds of the banks which were in custody of the State. The latter method was chosen—probably because it appeared to be the most equitable. Clearly it is more desirable to charge the cost of the public supervision services against that portion of the public (*i. e.*, the depositors, stockholders and creditors of the bank) who most directly benefited. The method used is essentially the fee method, for a fee is nothing but a pre-estimated cost of a given service. However, here the amount charged was limited to actual cost, and amounted merely to a special assessment against the banks' funds in the amount of the specific expenses incurred by the State.

It is thus clear that neither the method used by the State in securing the funds to pay Freedman his salary nor the source of those funds in any way changes his status as a State instrumentality. That being so, he is clearly entitled to exemption, if the only objection be that as to the source of his compensation.

5. *It has always been recognized that taxation of a governmental officer or employee lays an unconstitutional burden on the sovereign, and that the degree of the burden is immaterial.*

Since right to immunity results from an inherent lack of jurisdiction in one sovereign to tax the governmental agency of the other sovereign, obviously it is immaterial whether a particular tax results in a financial burden. Apparently the

cases have discussed the matters of "burden" and "interference" as illustrative of reasons supporting an interpretation of the Federal Constitution which preserves to each government independence of action in their respective spheres. That the cases have not rested the immunity principle solely upon the possibility of a financial burden is stated in the *Dobbins* case, at page 449:

> "But the unconstitutionality of such taxation by a State as that now before us may be safely put—*though it is not the only ground*—upon its interference with the constitutional means which have been legislated by the government of the United States to carry into effect its powers * * *."

The cases have proceeded on the sound assumption that *necessarily* the taxation of the compensation of a governmental employee will burden or interfere with the functions of the government which employs him. That some burden or interference in fact results has been so long and so frequently recognized by the courts as not now to be open for question. In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523, this Court said:

> "Taxation by either the state or the federal government affects in some measure the cost of operation of the other".

In *Macallen* v. *Massachusetts*, 279 U. S. 620, 628, the Court held:

> "Not only may the power to tax be exercised oppressively, but for one government—state or national—to lay a tax upon the instrumentalities or securities of the other is derogatory to the latter's dignity, subversive of its powers, and repugnant to its paramount authority."

The Solicitor General in his brief in the Dravo Contracting Company, at page 5, said:

> "Any tax will be reflected in greater or less degree in the costs which the sovereign must pay."

Thus to the extent that the question of a *financial burden* is at all material in considering the immunity of a governmental officer or employee, the fact of a burden is judicially determined and admitted by the Government, speaking through its Solicitor General. The fact that there is such a financial burden on the State supports the claim to exemption here, but does not appear in itself to be determinative of the question.

Furthermore, the decisions are unanimous in holding that the extent or degree of the burden or interference is wholly immaterial. As stated in *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, 575:

> "Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute. *McCulloch* v. *Maryland*, 4 Wheat. 316, 430; *United States* v. *Baltimore & Ohio R. Co.*, 17 Wall. 322, 327; *Johnson* v. *Maryland*, 254 U. S. 51, 55-56; *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505; *Crandall* v. *Nevada*, 6 Wall. 35, 44-46."

There is another consideration. Mr. Chief Justice Hughes in the *Dravo* case pointed out that should any State lay a tax in such an amount as to substantially interfere with the Federal Government's power to obtain the service it needs, it has adequate power to prevent such interference. In case, however, the Federal Government should lay a tax of such magnitude as to impede a State in obtaining the service it needs, there is considerable doubt whether it has adequate Constitutional power to prevent such interference. Hence, there is even more reason that no consideration be given to the extent of the interference or to the weight of the burden in a case where there is a Federal tax sought to be laid on a State agency.

6. *Taxation of the employee's salary would interfere with the State's freedom of choice in its agents.*

It is of the essence of sovereignty that the sovereign shall be free to select those instrumentalities which are *or who*

are best adapted to the sovereign's needs. If it chooses to select individuals who will serve without compensation for the honor of service, it may do so. If it chooses to create a public corporation, it may do so. Its hands are not to be stayed by another sovereign. Now, it is clear that in the choice of human instrumentalities, the element of taxation upon compensation plays a vital part. It need not be argued that in each instance the sovereign must make up the tax in increased compensation. It is sufficient that the inducements the State may offer are cut down. It is sufficient to show an *interference* with the State's offer of compensation. Once this is shown, it necessarily follows that the sovereign's right to have a free choice of public servants is interfered with. Nothing more need be shown. To be sure, there is always competition between the attractiveness of public office and the greater compensation of private employment. Yet every man who studies his own budget knows that it is the *net* income upon which he relies in budgeting his living expenses—not the gross.

It is beside the point to argue that there is someone always ready to take the place of one who resigns from public employment. The fact is that men acquire knowledge and expertness by reason of their service in governmental employ. The community has an investment in the judge on the Bench who has served many years. The fact that if he retires someone is ready to take his place, is also beside the point. If reduction in his salary would tend in any degree to lead him to withdraw from public service, the sovereign's power to continue such an expert in its employ is directly interfered with. It is no answer to say that men who care for the honors of public office are likely to continue to make sacrifices. It is no answer to say that they may be able to make up the difference from the private incomes. *The real question is, has the State the necessary freedom to choose the type of instrumentality it desires?*

This issue was clearly decided in the *Rogers* case. There this Court said (p. 408):

> "The power of the federal government to use a corporation as a means to carry into effect the substantive powers granted by the Constitution has never been doubted since *McCulloch* v. *Maryland*, 4 Wheat. 316."

It is for this reason that the Court, finding that the selection of a corporation was necessary to the freedom of the exercise of the powers of sovereignty, applied the same doctrine to the lawyer employed by the corporation whose salary the State sought to tax.

Recently, the Solicitor General, Mr. Stanley Reed, in arguing *Dravo Contracting Company* case said that there was a great distinction between a tax on the salary of an employee of government and a tax on an independent contractor. He said in his argument there that a governmental employee is a part of the government itself, that such an employee has a continuity in and of the government, and that he represents and stands in the place of the government. The Solicitor General furthermore said that any attempt to tax an employee of the National or a State government *is a direct interference with its operation.* In concluding his argument, Mr. Reed said that if the Government were to ask a disregard of the principle of reciprocal immunity, it should have no standing even to be heard before the Court. He argued, too, in that case that taxing securities of a State or of the Federal Government was similarly distinguishable from a tax on an independent contractor, because bank holdings of Federal and State bonds form the very basis of our currency system, and any attempt to tax such an instrumentality of government would constitute a direct interference with the fiscal affairs of government.

The Court is not concerned with the question of the *extent* of the tax. The courts do not undertake to determine when the *amount* of any tax will constitute a burden and when it will not. Once we concede the power to levy a one per cent. tax, we concede the power to levy a fifty per cent. tax. The Court in these cases is concerned only with the *principle.* The interference with the sovereign's power and freedom to

choose employees and to offer whatever inducement in the way of compensation it may decide to offer, either to enter into or *remain* in its service, is certainly an unconstitutional "burden".

7. *The immunity doctrine has so long been in effect, and the States have so ordered their fiscal affairs accordingly, that the rule ought not to be disturbed.*

In the recent case of *Elkins* v. *Commissioner*, 91 F. (2d) 534, where the Commissioner challenged long standing Departmental practice, the court said:

> "Beyond the purpose of the taxing authorities to exact more from taxpayers, there is no logical reason to reverse this ruling of many years * * *."

Likewise here the fundamental reason for the challenge to the long-established Constitutional principle of immunity seems to be merely the desire of the Government to get more taxes. It is not as though there were not already many subjects of Constitutionally valid taxes. There is no real threat that the Federal Government will be left without sources of revenue. It simply is an attempt of one government to collect certain revenues at the expense of or to the embarrassment of the other government.

Many States, municipalities and State agencies have issued bonds to raise funds to establish and maintain particular governmental projects, such as bridges, traffic tunnels, and the like, and have provided that the interest on the bonds be paid out of tolls or other charges for the use of such facilities. If the Commissioner's theory be adopted, then such bond interest could no longer be regarded as exempt from the Federal income tax. This would strike down established methods of financing State activities, and would interfere with the States' freedom of choice in the methods of financing their projects.

If the source of the funds is to be considered, then it would have to be considered in every case where the com-

pensation was not paid directly out of general taxes. For example, the salary of the Clerk of this Court is paid out of the private funds of litigants who appear before the Court in just as real a sense as was respondent's salary paid out of the private funds of the banks whose liquidation was being supervised by the State of Pennsylvania. This Court is authorized to charge certain fees. Judicial Code, Sec. 223, Act March 3, 1883, c. 143, Sec. 1, 22 Stat. 631. That the Clerk's salary is a first charge against these fees was pointed out in *Bean* v. *Patterson*, 110 U. S. 401. But would this Court uphold the validity of a State income tax on his salary because he is paid out of such fees?

The Commissioner apparently will not carry his argument so far as to conclude that a salary paid out of fees so collected and covered into the treasury of one sovereign would be subject to income tax by the other. Cf. Commissioner's brief in *Therrell case*, p. 7. But there can be in principle no valid distinction between the payment of salaries out of fees charged for special services rendered by the State, whether or not covered into its treasury, and the payment of salaries out of other funds physically commandeered by the State and used by it to pay public employees for special services rendered to the original owners of such funds. As already stated, the difference relates merely to the method employed by the State in obtaining the funds to meet its own obligations. Before the Act of March 3, 1883, referred to in *Bean* v. *Patterson, supra*, apparently the Clerk of this Court was entitled to retain as his own all fees collected in excess of the expenses of his office. As the Court is aware there are still many States that authorize various officials to collect prescribed fees and to retain same as their compensation. Can it reasonably be urged that simply because of this particular method used in paying the officer or employee he thereby loses his right to claim exemption of his compensation from the Federal income tax, whereas a fellow officer or employee is concededly entitled to claim exemption because of the happenchance that his salary was

paid out of funds in the State treasury derived from general taxation?

This also illustrates the fundamental unsoundness of the principle contended for by the Commissioner. It would serve to classify State and Federal employees, not according to what they do, but according to how they happen to be paid.

The adoption of the Commissioner's principle would obviously necessitate an extensive overhauling of the methods of financing governmental activities. It is common knowledge that the tendency in recent years has been for both the State and Federal Governments to earmark certain receipts (whether collected as taxes, as fees, or otherwise) for the payment of the expenses of a governmental department or agency rendering a particular service to the individual citizens from whom the collections are made. It is but reasonable to surmise that the adoption of any such rule as that contended for by the Commissioner would merely drive the States to adopt a different method of accounting and of payment of salaries of officers and employees engaged in such governmental activities. To assure tax exemption to its officers and employees a State would merely have to provide that the special charges be paid into its treasury to the account of the general fund and that the salaries be paid out of this general fund. Such an involved process of changing the form of the transaction, without changing the substance, would remove the very ground of the Commissioner's claim for a tax in a case such as the present. It is clear, therefore, that the Commissioner's argument is predicated upon a matter of mere form of payment and not upon a matter of real substance. This Court has repeatedly held that in tax matters substance and not form should control.

The Commonwealth of Pennsylvania, frequently employs the sound policy of providing for the expenses of particular governmental functions, especially regulatory functions under the police power, by assessing the entire cost against the subject matter of the particular function. That is essen-

tially the case here. Sec. 9 of the Act of May 21, 1919, P. L. 209, provided that from and after the date of the approval of the Act—

> "all moneys derived by the Banking Department from fees, assessments, charges, penalties, and otherwise, shall be paid by the Commissioner of Banking into the State Treasury for safe-keeping, and shall, by the State Treasurer, be placed in a separate fund, to be available for the use of the Banking Department upon requisition of the Commissioner of Banking. All such moneys, so paid into the State Treasury, are hereby specifically appropriated to the Banking Department for the purpose of paying the salaries of the Commissioner, the Deputy Commissioners, the Examiners, and the other employees of the Department, and the expenses of the Department, including the rental of such rooms or quarters as the Commissioner of Banking may deem necessary outside of the Capital."

The method of paying the salaries of the head of the Banking Department and of all of his employees, which was inaugurated by that Act, has been continuously adhered to, although the old Act of 1919 is no longer in force. See Act of June 15, 1923, P. L. 809, Sec. 9, as amended by the Act of April 13, 1927, P. L. 182; Act of April 25, 1929, P. L. 716; and Act of May 15, 1933, P. L. 796. By the last mentioned amendatory Act this plan of paying Department of Banking expenses was extended to the supervision of the Department over building and loan associations. All of these Acts were repealed by the Act of May 15, 1933, P. L. 111, known as the Department of Banking Code, and Sec. 204 of this Act substantially restated the law as it previously existed. This is the current statute which provides that both banks and building and loan associations shall pay the cost of examination and supervision by the Department of Banking. Today there is no appropriation whatever out of the general funds of the Commonwealth to support the work of the Department of Banking.

The same method of financing the work of the Insurance Department of Pennsylvania is also in force. See Act of May 17, 1921, P. L. 789, Art. II, Sec. 211, as amended by the Act of April 7, 1927, P. L. 161, Sec. 1.

In the cases of examinations of banks, building and loan associations and insurance companies, the State now assesses the institution examined with the actual per diem cost of the examination computed according to the actual salaries and expenses of the examiners engaged in the work. An additional charge to cover the general overhead of the Departments is made against all supervised institutions according to the book value of their assets *pro rata*.

A modification of this method also prevails for financing the work of the State Game Commission and the State Fish Commission. In these cases, license fees are charged for the privilege of hunting and fishing, the fees are placed in special funds in the State treasury, and all expenses of supervision incident to the acquisition and maintenance of game preserves and fish hatcheries and the enforcement of the Game and Fish Codes are paid out of these funds. Not a penny of the State's general revenue is used for this purpose.

To a large extent the work of the Department of Highways is similarly financed. All motor license and drivers' license fees are paid into a special fund in the State treasury out of which are paid all of the expenses of the head and subordinate officers of the Department of Highways.

The adoption of the principle contended for by the Commissioner would then necessitate an examination into the source of the funds used to pay all these hundreds of State employees, and would require a holding that such of them as were not paid out of general taxes were not State instrumentalities carrying out governmental functions. That is not a sensible result. As above stated it would set up gross discrimination between classes of State employees, according not to their duties but to how they are paid.

In considering practical objections to a change in the

rule it should not be overlooked that the Commissioner's theory would inject greater uncertainty into the field of taxation and tend greatly to increase the already too large amount of tax litigation. Tax cases now clog the courts. But if the tax status of each State and Federal Government employee is to be determined by reference to the source of the funds used to pay his compensation then the number of tax controversies will be enormously multiplied. We now have a sound and workable rule that has stood the test of time. Here the maxim *stare decisis, et non quieta movere,* applies with great force.

8. *Any change in the immunity doctrine is a political question and ought to be left to a decision by the People upon submission of an appropriate amendment to the Federal Constitution.*

It is not clear whether the Commissioner here seeks a complete re-examination by this Court of the application of the reciprocal immunity principle in the case of governmental officers and employees. He says it is unnecessary to question the principle of *Collector* v. *Day*. But the result he seeks is so inconsistent with the rule of that case that he must at least seek a drastic limitation on the immunity doctrine. But this principle is of such long standing as to have become a part of our fundamental law. Apparently there is no longer left a proper question for judicial determination. It is now a question as to whether the People of the Nation desire to establish a new and different Constitutional rule, as in the case of the Sixteenth Amendment adopted after this Court held the income tax invalid as a direct tax under the Constitution as it existed prior to such Amendment.

It is common knowledge that many bills have been submitted in Congress proposing amendments designed to permit taxation of both the interest of government securities and the compensation of government employees. None has yet passed. The citizens of the Nation, as they speak

through their duly elected representatives, have not yet evidenced a sufficient desire to change the rule. In this case we have but an attempt of the Federal Government to extend its taxing powers to a field not heretofore recognized by our Constitutional law. Mr. Justice Holmes in *Baldwin v. Missouri*, 281 U. S. 586, 595 (1930), warned against the cutting down of the established constitutional rights of the States, saying:

> "I have not yet adequately expressed the more than anxiety that I feel at the ever increasing scope given to the Fourteenth Amendment in cutting down what I believe to be the constitutional rights of the States. As the decisions now stand, I see hardly any limit but the sky to the invalidating of those rights if they happen to strike a majority of this Court as for any reason undesirable."

II. The court below correctly held that, upon the Board's findings of fact, respondent must be classed as an employee of the Commonwealth of Pennsylvania.

Although the errors assigned in the petition for the writ and in the Commissioner's brief are broad enough to present this question for consideration, we are not sure whether the Commissioner intends to urge in this Court that respondent was not an employee of the State. Applying the principles established by the decisions of this Court, and by the great number of decisions of the lower courts and the Board of Tax Apeals, to the facts as found by the Board it seems clear that petitioner must be classed as an employee, and that there are no substantial grounds for claiming that he had the status of an independent contractor.

In his notice of deficiency, which was the basis of the appeal to the Board, the Commissioner did not claim that respondent was not an employee, but rested his denial of exemption on the ground that the source of the compensation precluded the application of the principle of immunity (R. 7-8). While in the Board of Tax Appeals the Commis-

sioner did urge that Freedman was an independent contractor, the Board in its opinion (R. 16-21) did not pass upon the question, resting its decision on the "basic ground" that the "source of his income precludes any possibility of a burden on the State resulting from a tax thereon" (R. 17).

The Commissioner in the court below made the point that Freedman was not "an employee of the State of Pennsylvania, so far as the rule of immunity is concerned", although specifically recognizing "that the petitioner here might well have been held to be an employee of the State of Pennsylvania under the facts held by the Board" (Commissioner's brief below, p. 40). On this issue the Circuit Court held (R. 64):

> "The uncontradicted testimony of the taxpayer was that 'the Department of Banking had absolutely no authority over me. They did not instruct me as to what banks I was to work. The Attorney General did that.' The Deputy Attorney General testified: 'It was considered that these men were available for any purpose at any time with the Department of Justice. They were controlled entirely by that department'. In view of this uncontradicted evidence, we hold it proven that the taxpayer was an employee of the State acting by its Attorney General."

The accuracy of the findings of fact made by the Board is not challenged. We are not, therefore, confronted with any problem as to whether there was substantial evidence before the Board to support its findings. Here the "function of the court is to decide whether the correct rule of law was applied to the facts found." *Commissioner* v. *Rankin,* 295 U. S. 123, 131. We submit that, on the facts found by the Board, the court below correctly held that Freedman was an employee and not an independent contractor, as those terms are defined in the many decided cases.

In *Commissioner* v. *Coughlin,* 87 F. (2d) 670, after quoting the relevant provisions of Art. 643, of Reg. 74, which

are identical with the provisions of the regulations applicable in this case, the court approved those regulations and defined an "employee" as follows:

> "According to those Regulations an employee is (a) one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and (b) one whose services are continuous, not occasional or temporary. In addition, the decided cases stress the importance of supervision and control. Where there is no supervision or control, where the employment is occasional, where the duties are not prescribed, the courts have concluded that the taxpayer was not an officer or employee and that his compensation was not tax-exempt."

The nature of the required control in the case of an employee who is a professional man is well stated in the case of *Curren* v. *Commissioner*, 34 B. T. A. 946, (affd. 90 F. (2d) 621, C. C. A. 2nd), where it was held, with respect to an attorney appointed as counsel to a county court clerk, that:

> "While it is true that petitioner was required to exercise, and did exercise, his independent judgment and best professional skill in rendering the services here involved, that is true in the majority, if not in all, of the cases where a professional man is employed. A chemist, bacteriologist, or technician in a laboratory, whether employed by a private industry or by a political subdivision, is required to exercise his independent judgment and best professional skill in performing the task assigned; but he may nevertheless be an employee if his employer retains the right of control over his activities and can direct how and when he shall perform his work. If, however, either an industry or a municipality engages a technician to deliver to it a completed task, and exercises no control over the means or instrumentalities whereby the results sought are achieved, and has no right to exercise such control, then the relationship between the parties is that of independent contractor rather than employer and employee.
>
> The courts and this Board has applied the above test in many cases and have held that even in the absence of

> the actual exercise of the right of detailed control, a professional man nevertheless may be an employee. Some of the cases are: *Charles J. Tobin*, 17 B. T. A. 1261; *Frederick A. Brown*, 22 B. T. A. 581; *D. F. Strickland*, 16 B. T. A. 419; *Burnet* v. *Livezey*, 48 Fed. (2d) 159; *R. E. McIntosh*, 16 B. T. A. 1400; *B. F. Martin*, 12 B. T. A. 267; *W. B. Mathews*, 13 B. T. A. 1133; *Rosalie C. Rand, Executor*, 27 B. T. A. 182; *George H. Harlan*, 30 B. T. A. 804; affd. 80 Fed. (2d) 660; *Jermiah Wood, supra; Joseph J. Sullivan*, 33 B. T. A. 629; *John B. Hittell*, 33 B. T. A. 276. The crucial test is the *right* to exercise control, which we believe the evidence clearly indicates the county clerk had as to this petitioner."

The facts in the instant case establish beyond question that the Attorney General had the right to direct not only what Freedman should do, but *how* he should do it; and the Attorney General not only had the right but fully exercised it. He did not leave Freedman to his own discretion. Instead, as specially found by the Board (R. 14) respondent—

> "was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the Attorney General's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the Attorney General and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the Attorney General."

Not only is there here present that "control or right of control by the employer which characterizes the relation of employer and employee and differentiates the employee or servant from the independent contractor" (*Metcalf & Eddy*

v. *Mitchell,* 269 U. S. 514, 521), but there are also here present those other factors deemed by Art. 643 of Reg. 77, *supra,* as establishing the relation of employer and employee. That regulation, which controls this case, provides:

> "An employee is one whose duties consist of the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary".

There can be no question but that respondent was employed to, and did render "*prescribed services*". His appointment as an attorney in the Department of Justice was made by the Attorney General pursuant to a specific statutory provision giving that official power to make the appointment (R. 12). The powers of the Attorney General and the Department of Justice are defined by the Pennsylvania Administrative Code and by other state statutes. The very terms of respondent's appointment were that "you will be available to assist them (the Special Deputy Attorneys General) in any way in which they may find it necessary to call upon you" (R. 12). The Board found (R. 13-15) that:

> "The petitioner was assigned to work under Special Deputy Attorneys General in Philadelphia County in connection with legal matters pertaining to closed banks in that county. * * * The petitioner's duties consisted * * * and 'in general anything that was assigned by the Special Deputy Attorney General at the time'. Such attorneys were considered by the Department of Justice as 'available for any purpose at any time.' * * * The particular work and the matters to which the petitioner gave attention were determined by the Attorney General's office. * * * The petitioner's duties and the manner in which they should be performed were prescribed in part by a large number of mimeographed circulars issued by the Attorney General at Harrisburg at frequent intervals and sent to all attorneys handling closed bank matters. Also, his instructions were received periodically from a Deputy Attorney General at regular meetings held for the pur-

pose of discussing their problems and deciding on procedure."

Also Freedman's services were "continuous, not occasional or temporary". He served for a continuous period of 3 years and 4 months (R. 11-12). He was not appointed for any given period of time (R. 12). He was simply appointed as an attorney in the Department of Justice at a salary, pursuant to provisions of State law, and was removable at the will of the Attorney General, as in case of all such attorneys in that Department. Respondent was actually removed by action of a new Attorney General (R. 12, 32).

Material also (cf. *Coughlin* v. *Commissioner, supra*) is the fact that respondent received a fixed annual salary, payable bi-monthly in the same way and at the same time as other State employees (R. 15). No matter how much of his time or what the character of his services he was entitled to receive $3,000 per year, and no more (R. 15). While he was only called upon to give about 50 per cent of his time to the State in 1932, the Board found that "the Department of Justice could have required all of his time and had first call on his services" (R. 15).

Another controlling factor is the fact that respondent's duties were not prescribed by any contract but solely by his superiors in the Department of Justice. Here there was no contract defining his duties. If told to do something respondent could point to no contractual right which limited his services; he had but to obey, or to resign.

III. Respondent was employed by the State in the enforcement of its statutes relating to the regulation of banking and was necessarily engaged in carrying out essential governmental functions of the State, this having been conceded by the Commissioner in the court below.

When this case was before the Board, counsel for the Commissioner presented a brief argument—hardly more than a suggestion—that Freedman's services were not rendered in

connection with the exercise of an essential governmental function of the Commonwealth of Pennsylvania. The Board did not mention this question in its opinion (R. 16-21). It is significant that in the deficiency notice (R. 5-9) the Commissioner did not deny exemption on any such ground.

In the court below the Commissioner not only did not raise the point but conceded Freedman to have been engaged in an essential governmental function. In the brief there, at pages 12 and 14, counsel for the Commissioner stated:

> "We recognize that the State of Pennsylvania, and each other state, has the capacity under its police power to regulate banking within its boundaries and under that power to take over and liquidate insolvent banks. *Engel* v. *O'Malley*, 219 U. S. 128; *Noble State Bank* v. *Haskell*, 219 U. S. 104; *Therrell* v. *Commissioner* (C. C. A. 5th), decided March 9, 1937.
>
> • • •
>
> Since the State of Pennsylvania admittedly has the power to take over and liquidate insolvent banks and that power was exercised here, we come to the question of whether the rule of immunity applies in this case to exempt the compensation received by the petitioner from Federal income taxation in assisting the state in certain liquidations."

In the light of such admission the court below was not called upon and did not pass on the question now raised by the Commissioner in the first point of his brief in this Court. The court below rested its decision on the express assumption that Freedman was "an employee of the State engaged in recognized Governmental work—in this case the vital Department of Banking (*Therrell* v. *Commissioner*, 88 F. (2d) 869)."

In the first place, Freedman was an employee of the Pennsylvania Department of Justice—he was a law enforcement officer. He was subject to call for any duties in that Department which the Attorney General might have prescribed

(R. 13-14). It happens he was assigned to give legal assistance in enforcing those State statutes having to do with the liquidation of insolvent State banks. Whatever the character of the laws he may have been called upon to enforce, we submit that simply as a law enforcement officer he was necessarily engaged in the performance of essentially governmental functions.

But even if the case is viewed from a narrower angle, and his employment considered as limited (which it was not) to matters relating to closed banks, nevertheless we come to the same conclusion.

The supervision and control of banking has been considered as a governmental function since the beginning of our government, both by the Federal and by every State Government. It is expressly so recognized by the Pennsylvania Constitution and statutes. Pennsylvania Constitution of 1874, Art. XVI, Sec. 10, and Art. XVI, Sec. 11, as amended November 2, 1930. The subject has been deemed of such public importance that a separate executive department of the State Government known as the Department of Banking was created. Act of April 9, 1929, P. L. 177, Art. II, Sec. 201. It is given wide supervisory and regulatory powers over both going and closed banks. Further, banking is of such public importance that in 1933 the legislature adopted an entire "Department of Banking Code." Act of May 15, 1933, P. L. 111.

As pointed out in Appendix B to the Commissioner's brief in the *Therrell* case, in essence the procedure adopted by the Commonwealth of Pennsylvania for the liquidation of insolvent banking institutions, is "administrative determination of insolvency, followed by administrative liquidation or administrative appointment of receiver; subject to limited judicial supervision." Purdon's Statutes, Title 7, Secs. 21-50.

In *Pennsylvania* v. *Williams*, 294 U. S. 176 (1934), this Court held that the provisions of the very same laws which Freedman was here employed to help enforce, created the

Pennsylvania Secretary of Banking a State agency of such a character that its functioning should not be interfered with by the Federal Government, acting through its courts. That was a suit in a Federal District Court by a shareholder for the appointment of receivers to liquidate an insolvent building and loan association, appropriate jurisdictional facts appearing. The Commonwealth of Pennsylvania intervened and petitioned the District Court to surrender possession of the assets of the association to the Secretary of Banking in order that he might liquidate its affairs pursuant to the Pennsylvania Banking Act of 1923, P. L. 809, as amended. This Court held that the District Court should have relinquished its jurisdiction in favor of State administration by the State officer, saying, Mr. Justice Stone writing the opinion:

> "Here no state court is asserting jurisdiction, but the state officer, charged by the statutes of the state with the duty of supervising its own building and loan associations *and of liquidating them by an adequate procedure when insolvent,* asks to proceed with the liquidation. See *Amos* v. *Trust Co. of Florida,* 54 F. (2d) 286, 288 (C. C. A. 5th).
>
> A court of equity, which in its discretion may refuse to protect private rights when the exercise of its jurisdiction would be prejudicial *to the public interest,* see *Greathouse* v. *Dern,* 289 U. S. 352, 359, 360, or deny relief upon performance of a condition which will safeguard the *public interest* and secure substantial justice to the complainant, see *Harrisonville* v. *Dickey Clay Co.,* 289 U. S. 334, 338, would seem bound to stay its hand in the *public interest* where it reasonably appears that the private right will not suffer. It is in the public interest that federal courts of equity *should exercise their discretionary power with proper regard for the rightful independence of state governments in carrying out their domestic policy.* * * * It has long been accepted practice for the federal courts to relinquish their jurisdiction in favor of the state courts, where its exercise would involve control of or interference with the internal affairs of a domestic corporation of the state. * * *

There are stronger reasons for adopting a like practice where the exercise of jurisdiction involves an unnecessary interference by injunction with the lawful action of state officers. Matthews v. *Rodgers, supra,* 525."

This Court has thus expressly recognized that the liquidation provisions of the Pennsylvania Banking Act are in the "public interest" and transcend the mere protection of "private rights." The denial of the right of the District Court to retain jurisdiction of the liquidation proceedings was grounded upon the very principle which Freedman asserts precludes the Federal taxing authorities from taxing his services rendered in enforcing those same State laws, namely, that it would result in "an unnecessary interference * * * with the lawful action of state officers." We believe that the decision in *Pennsylvania* v. *Williams* leaves no room for an argument that the supervision of the liquidation of insolvent Pennsylvania financial institutions is not an exercise of State governmental functions of such a characted that they may not be interfered with by the Federal Government.

We believe that the assumption by the Commissioner in his argument in the court below that the taking over and liquidation of insolvent banks is a usual or essential Governmental function is sound, and that the position which he now takes in this case and in the *Therrell* case is clearly erroneous. "The business of banking is a proper subject for regulation under the police power of a state because of its nature and the relation which it bears to the fiscal affairs of the people and the revenue of the state." 7 C. J. 480.

In his brief (pp. 11-12) in the *Therrell* case the Commissioner urges that the "liquidation of financial institutions by the states" is not an essential governmental function. However, at the outset, he "concedes that the *regulation* of the state banking institutions is an essential governmental function" but contends that *liquidation* thereof is within the "zone of debatable ground" referred to in

Brush v. *Commissioner*, 300 U. S. 352, 365, and "more akin to the operation * * * of the state financial institutions". His argument then goes off on the narrow issue as to whether a bank liquidator, although an administrative officer of the State, is to be considered as merely carrying on a private banking business reduced "in the scope of the activities". He argues that since the activities of a solvent bank include the sale of assets and the collection of loans, and that since the liquidator's duty consists chiefly in carrying out these same activities, it follows that the liquidator is carrying on an ordinary banking business. Such argument proves too much. It goes without saying that a private banking business is conducted primarily for the purpose of making a profit. The nature of any undertaking is determinable by reference to its *purpose*. But the activities of a liquidator have no such purpose of gain, but, on the contrary, the opposite purpose of *closing up* a going business. The winding up of a business is the very antithesis of carrying on an enterprise. His purpose is to insure a fair and economical liquidation to the end that the interests of the general public, the creditors, the depositors, and the shareholders of the insolvent bank may be protected, that no one group may be permitted an advantage over another, and that there may be a minimum of disturbance in the fiscal affairs of the State and the citizens. Thus his activities clearly are essentially regulatory in nature.

Helvering v. *Powers*, 293 U. S. 214, is not only no authority in support of the Commissioner's contention but affirmatively supports the view that liquidation of financial institutions is a governmental function. It was there held that public trustees of the Boston Elevated Railroad Company were not entitled to tax immunity on the ground that their activities were not of a governmental nature, because, as stated by the Court at page 223-224:

> "While the undertaking is for the public benefit, it is still a particular business enterprise—the operation

> of a street railway—and the functions of the trustees are limited accordingly. * * * the operation by the trustees is intended to be self-sustaining. The transportation service is to be rendered, * * *. The authority given to the trustees 'to regulate and fix fares,' and the further authority to ascertain such losses as may be incurred, which are to be borne by the Commonwealth, are both incident to that main purpose."

So in the *Powers* case the *main purpose* was the *continued operation* of an ordinary private business enterprise—not its regulation. Here, on the other hand, the only purpose is the regulation of the processes of liquidation. Concededly the State had the power of regulation. It is immaterial how this power is exercised. As long ago laid down by Chief Justice Marshall in *McCulloch* v. *Maryland*, 4 Wheat. 316, 409:

> "The government which has a right to do an act, and has imposed on it the duty of performing that act, must, according to the dictates of reason, be allowed to select the means; and those who contend that it may not select any appropriate means, that one particular mode of effecting the object is excepted, take upon themselves the burden of establishing that exception."

That the liquidation of insolvent banks is a commonly accepted governmental function of the States is not open to question. The Commissioner's brief itself demonstrates this. He attaches to his brief as Appendix B a rough classification of the procedures adopted by the several States for the liquidation of insolvent banking institutions. Every State in the Union has a law on the subject.* If not historically an essential governmental function, administrative liquidation has become such by reasons of modern conditions recognized generally by the State legislatures

*The Commissioner makes reference to the statutes of every State except Indiana. That State also provides for administrative liquidation. Burns' Ind. Statutes (1933), Sec. 18-301.

as requiring public rather than private liquidation proceedings.

The argument is also made that since the banks were subject to Federal taxation before being taken over by the State the case is governed by the principle stated in the *Powers* case that one of the limitations on the principle of immunity is—

> "that the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the federal taxing power would normally extend."

Such contention is clearly invalid. It assumes that supervising the liquidation of banks is a "business" and also involves "a departure from usual governmental functions" neither of which has a factual basis. State supervision of insolvent financial institutions is not now, and never has been, a business. That activity has never been subject to Federal taxation. As pointed out by the court below (R. 65)—"As the national banks are 'instrumentalities, means and operations' whereby the Federal Government exercises a governmental control over them, so the state exercises like governmental control over state banks, * * *". The court in the *Therrell* case seems clearly correct in its holding that the—

> "orderly winding up of State banks is a true governmental function of the State resting not only on its fiscal needs and powers but also on its police powers."

The Commissioner makes the curious point that the liquidation of insolvent banks cannot be an essential governmental activity, for purposes of applying the immunity rule, "because many states permit or require the activity to be undertaken by the Federal Government itself". But this argument seems only to show even more clearly that

the function is considered by both the Federal and State Governments as so essentially governmental and of such nation-wide public importance that their efforts should be coordinated. The fact that the State surrenders a power to the Federal Government or, rather, makes the Federal Government the agent of the State to carry out more effectively the powers of regulating local banks, cannot be a point against the governmental character of the function. To carry the Commissioner's contention to its logical conclusion would authorize the several States to tax the compensation of all the officers and employees of the Federal Deposit Insurance Corporation. That agency has strenuously resisted taxation by the State of the salaries of its employees on the ground that this constitutes a direct interference by the States with the activities of a National instrumentality. It has been sustained in that contention only recently. In a formal opinion dated October 25, 1937, the County Board of Review for Dana County, Wisconsin, in a preceeding entitled *In Re Fred W. Niles,* held the salary of Niles, received as an employee of that Corporation, was exempt from the Wisconsin income tax, on authority of *New York ex rel. Rogers* v. *Graves,* 299 U. S. 404. The position of the Federal Deposit Insurance Corporation is that its liquidation and operation activities are but incidental to the undoubted power of the Federal Government to regulate banking in its national scope, just as the operation of a railroad and a canal in the *Rogers* case was considered but an auxiliary activity in the function of the Federal Government of providing for the National defense and the regulation of commerce.

Lastly, we come to consider *Brush* v. *Commissioner,* 300 U. S. 352. The Commissioner says it has no application. It was there held that maintenance of a municipal water supply system was a governmental function. The Commissioner seeks to limit that case to a situation where there is a showing as to the necessity of the State activity, and argues therefrom that the State "would continue to exist

without substantial change whether or not a State official undertook the liquidation of insolvent banks". The trouble is with the premise. In the *Brush* case the Court laid down no such doctrine of necessary function but, on the contrary, rejected it. In the argument of that case it was strenuously urged by the Government that a municipality could get along without a publicly owned or operated water supply, it being pointed out that many cities and towns were served by private companies. The true principle of the *Brush* case is that specifically stated in the opinion that—

> "if the State and City of New York be of opinion, as they evidently are, that the service should not be entrusted to private hands but should be rendered by the city itself as an appropriate means of discharging its duty to protect the health, safety and lives of its inhabitants, we do not doubt that it may do so in the exercise of its essential governmental functions."

In this case the People of Pennsylvania have clearly expressed their "opinion", through the enactment of statutes by the legislature, that the liquidation of closed banks should not be entrusted to private hands, but should be undertaken by the State itself. The State policy is expressed in the following statutory provisions:

> "*Enforcement of Banking Laws.*—The Department of Banking shall enforce and administer the laws of this Commonwealth in relation to all corporations and persons under its jurisdiction, and shall see that the greatest possible safety is afforded to depositors therein or therewith, and to other interested persons." (Act of April 9, 1929, P. L. 177, Art. XVI, Sec. 1603.)

Just as in the *Brush* case the "acquisition and distribution of a supply of water for the needs of the modern city involves the exercise of essential governmental functions", so here the establishment and maintenance of an adequate and responsible banking system for the needs of the modern State and its citizens involves the exercise of like essential

governmental functions. In this connection reference is made to the very sound argument presented under Point II of respondent's brief in the *Therrell* case.

The Commissioner of Internal Revenue long held that the functions of a State banking department are essentially governmental. In a ruling published in 1922 (I. T. 1316, I-1 C. B. 105), the Commissioner held in respect of employees of a state banking department:

> "Their employment is directly connected with the exercise of a State governmental function and is a part of the administration of the State banking laws."

In I. T. 2233 (IV-2 C. B. 47), issued in 1925, it was held:

> "The department of agriculture, the highway department, and the *department of banking* are agencies or instrumentalities of the State used in connection with the exercise of essential governmental functions of the State and the compensation of the officers and employees of such departments is exempt from income tax."

In I. T. 2214 (IV-2 C. B. 46) a State bank receiver claimed exemption. It was held:

> "His duties are prescribed by statute within the meaning of article 88, *and he is engaged in performing an essential governmental function, namely, the administration of the State banking laws.*
>
> * * * * * * * *
>
> In view of the foregoing, it is held that receivers of insolvent State banks in Kansas are officers of the State engaged in performing an essential governmental function and their compensation from this source is exempt from Federal income tax."

And again in 1933 the Commissioner ruled that the administration of State banking laws, including the supervision of liquidation of insolvent banks, is a governmental function. I. T. 2710 (XII-2 C. B. 79).

If the operation of a water supply system can be held to be a governmental function because an auxiliary to the sovereign power of preserving the health and life of citizens (*Brush* v. *Commissioner, supra*); if the operation of a railroad and a canal can be held to be a governmental function because an auxiliary to the power to provide for national defense and to regulate commerce (*Rogers* v. *Graves, supra*); and if the operation of a national bank is a governmental function because an auxiliary to the powers of the Federal Government to provide for the financing of its activities; then, upon every reason advanced in those cases, the liquidation of insolvent financial institutions, whether by the State or the Federal Government, and by whatsoever agency or instrumentality selected by them, must likewise be held to be a usual or essential governmental function, being an auxiliary to the undoubted sovereign powers to regulate banking and to provide for the financing of all public activities.

IV. In all events, respondent's salary is not taxable, because he has brought himself within the specific terms of the exemption prescribed by Art. 643, Reg. 77.

Since it is shown (a) that respondent received his salary as an employee of a State, and (b) that his services were rendered in connection with the exercise of an essential governmental function, it follows that he has brought himself squarely within the terms of Art. 643, Reg. 77, *supra*. In the concurring opinion of Mr. Justice Stone and Mr. Justice Cardozo in the *Brush* case they held:

> "We concur in the result upon the ground that the petitioner has brought himself within the terms of the exemption prescribed by Treasury Regulation 74, Article 643, which for the purpose of this case may be accepted as valid, its validity not being challenged by counsel for the Government."

The terms of this regulation are not open to challenge. They stand unrepealed and have repeatedly been considered

and sustained by the courts. *Commissioner* v. *Coughlin, supra.* Essentially similar provisions were contained in the regulations under all the prior revenue acts. Art. 643, Reg. 74 (1928 Act); Art. 88, Reg. 69 (1926 Act); Art. 88, Reg. 65 (1924 Act); Art. 88, Reg. 62 (1921 Act); Art. 85, Reg. 45 (1918 Act); Art. 5(g), Reg. 33 (1917 Act).

It will be noted that the regulations say nothing about the source of the funds used to pay the compensation. It is only recently that the Department has sought to question the long establishd immunity principle so concisely stated in its own regulations.

We cannot conclude without suggesting that any doubt as to the right to exemption, either under the terms of the regulations or under the principles of the doctrine of immunity, must be resolved in favor of the taxpayer; also that the so-called presumption against immunity from taxation must here give way to the superior principle of Constitutional law requiring a minimum of interference between the powers of the State and the Federal Governments. As stated in *Metcalf & Eddy* v. *Mitchell, supra:*

> "But neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence, the limitation upon the taxing powers of each, so far as it affects the other, must receive a practical construction which permits both to function with the *minimum of interference* each with the other."

And the fundamental reason for the rule, as announced in *McCulloch* v. *Maryland, supra,* likewise requires all doubts to be resolved in favor of non-interference with State powers. There Chief Justice Marshall said that the rule of immunity is "a principle which is safe for the States and safe for the Union", and that by it—

> "we are relieved, as we ought to be, from clashing sovereignty; from interfering powers; from a repugnancy between a right in one government to pull down what there is an acknowledged right in another to build up;

from the incompatability of a right in one government to destroy what there is a right in another to preserve."

CONCLUSION.

Respondent's compensation was a fixed annual salary paid to him by the Commonwealth of Pennsylvania for services rendered as an employee of such Commonwealth engaged in carrying out a proper governmental function, and such compensation is therefore not subject to the Federal income tax. Neither the method used by the Commonwealth to secure the funds with which to pay such salary, nor the source of those funds, are material.

It is submitted that the judgment of the Circuit Court of Appeals for the Third Circuit, holding the proposed tax invalid, should be affirmed.

Respectfully submitted,

JOHN W. TOWNSEND,
Attorney for Respondent.

December, 1937.

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Supreme Court of the United States

OCTOBER TERM, 1937.

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CLARENCE M. FREEDMAN,
Respondent.

BRIEF OF AMICUS CURIAE FILED ON BEHALF OF CHARLES C. STILWELL.

HERBERT POPE,
Amicus Curiae.

December 10, 1937.

THE DARTNELL-WALDEN PRINTING COMPANY, 310 WEST ADDISON, CHICAGO

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CLARENCE M. FREEDMAN,
Respondent.

BRIEF OF AMICUS CURIAE FILED ON BEHALF OF CHARLES C. STILWELL.

BRIEF OF AMICUS CURIAE.

We are filing this brief as *amicus curiae* on behalf of Charles C. Stilwell, the respondent in a case now pending on an appeal by the Commissioner of Internal Revenue from a decision of the Board of Tax Appeals to the Circuit Court of Appeals for the Seventh Circuit. The case is not yet docketed in that court and the decision of the Board of Tax Appeals is not reported.

We believe this court should be informed of the sole contention made by the Government in the *Stilwell* case be-

cause a similar contention is one of the contentions made in the *Freedman* case which is now before this court. That contention relates to the provision made by the state for compensation and in the *Stilwell* case involves fees, paid by authority of the state, to masters in chancery who perform services peculiar to the operation of government.

Stilwell was and is a master in chancery, appointed under the laws of the State of Illinois for the statutory term of two years. The Board of Tax Appeals held that he was an officer of the State of Illinois, performing a governmental function, and that his compensation, although not paid as a salary by the state, was not subject to federal income tax. In so holding, the Board followed its earlier decision in *Cochrane* v. *Commissioner,* 26 B. T. A. 1167, which involved the same question with regard to another Illinois master in chancery. In both cases the Government, while not denying that these masters were officers of the state, contended that, since under the state statutes these masters in chancery were not paid a salary by the state but received fees which were paid by litigants, their compensation was not immune from federal income tax.

The opinion in the *Cochrane* case recites the following stipulated facts (26 B. T. A. 1167):

> "The appointment of masters in chancery is authorized by the statutes of Illinois (see chapter 90, Smith-Hurd Illinois Revised Statutes, 1929). The statutory term of office is two years. The duties of the office are prescribed by the statute, which also provides for compensation in the form of fees, some of which are statutory and some fixed by the court. The masters are required to take an oath of office and to give bond."

The question presented on the appeal in the *Stilwell* case is the same question, involving the same taxpayers, that was presented and decided in the *Cochrane* case. That was

a test case, as appears by the stipulation of facts in the *Stilwell* case, and the Commissioner not only took no appeal in the *Cochrane* case but expressly acquiesced in the decision in favor of the exemption claimed. The *Stilwell* case is an attempt to try the same question over again for later years and presents the additional question of *res judicata* with which this court is not now concerned. But this court is concerned with the fact that for many years the Commissioner has ruled that in the case of unquestioned state officers the fact that they were compensated by fees had nothing to do with the right to exemption from a federal tax. A ruling was in fact made as early as 1918 in favor of the exemption of fees paid to Illinois masters in chancery, and this ruling remained in force until the question was raised in the *Cochrane* case as a test case in 1932.

It is of course a well known fact that justices of the peace in many states are paid by fees, but the Commissioner apparently has never raised any question about the taxability of such fees. And yet masters in chancery in many states, and certainly in Illinois, perform a governmental service which is of as much or greater importance than that rendered by justices of the peace. Many other state officers were also paid by fees and their right to exemption was not questioned until very recently.

Down to 1935 Article 643 of Regulations 77, as well as the corresponding provision of earlier regulations, was consistent with this view. It was a regulation made by the Secretary of the Treasury for the guidance of the Commissioner, was accepted as an interpretation of the decisions of this court regarding the constitutional exemption of state officers from federal taxation, and was not changed until 1935. Then the Treasury Department presumed not

only to reverse its own practical construction of this question during prior years, but also to issue a regulation (Article 116-2 of Regulations 86) which is inconsistent, in many respects at least, with express decisions of this court and with the reasoning upon which this court has based all of its decisions on this constitutional question.

This court has never held or suggested that the compensation of a state officer exercising distinctively governmental functions is subject to federal taxation if his compensation is derived from fees instead of from state funds. The fundamental inquiry in this court has always been the nature of the employment. This is the question that is carefully reviewed and considered in a recent case decided by this court, *Brush* v. *Commissioner*, 300 U. S. 352.

The dissenting justices in the *Brush* case made it clear that they disagreed only with reference to the character of the employment in that case and emphasized the fact that the services in question were of a character similar to those rendered to private employers. Mr. Justice Roberts, in his dissenting opinion (p. 377) says:

> "We are here concerned only with the question of the taxation of salaries or compensation received by those rendering to a municipality services of the same kind as are rendered to private employers and need not go beyond the precise issue here presented. * * * Nor are we called upon here to determine the validity of a nondiscriminatory tax upon the salary of a governmental officer whose duties and functions have no analogue in the conduct of a business or the pursuit of a profession, but are both peculiar to and essential to the operation of government."

In the *Stilwell* case we are concerned with services which admittedly are "peculiar to and essential to the operation of government," and the sole question involved is the method by which payment is provided for by the state.

Surely, in such a case it is for the state to determine how funds shall be provided to pay for the services of such an essential state officer. If the state provides for payment the compensation must be exempt from tax by the federal government no matter how or by whom the authorized payment is made.

A confusion of ideas is involved when an attempt is made to distinguish or question the source of the fund with which a governmental officer is paid. All the revenues of the state have the same source, and it is not necessary that funds to pay state officers shall first be paid out of general taxes into the state treasury in order that they may be regarded as state funds. If the state has the power to require persons directly benefited to pay for the governmental services rendered by a state officer, the federal government has no right to question the validity of the exaction or claim that the payment is not made out of state funds. Certainly when we are concerned with such governmental officers as justices of the peace and masters in chancery, whose compensation by many states over a long period of time has been provided for by fees paid by litigants, it is too late now for the federal government to raise a question about the source of the funds which provide such payments and require the states to change well established practices in order to avoid interferences by the federal government with the operation of their admittedly essential governmental functions.

The authorities have uniformly sustained this view of the matter.

The Circuit Court of Appeals for the Sixth Circuit so stated in *Bettman* v. *Warwick*, 108 Fed. 46, in an opinion written by Judge Lurton, subsequently Mr. Justice Lurton, of this court. He held that the question of tax im-

munity of a notary public was not determined by the source of the officer's compensation:

> "* * * That his services are compensated by fees and not by a salary, is of no importance. Many more important officials of the state are paid by fees. It is for the government that appoints him to determine how he shall be paid, and he is no less a governmental official because paid by fees * * * than if paid a stipulated salary out of the treasury of the state." (p. 48.)

In deciding the *Cochrane* case the Board followed this decision, pointing out that in many of the states "the so-called fee system is widely employed as a means of providing compensation for state, county and municipal officers employed in the performance of duties clearly of a strictly governmental nature. The alternative of the fee system would necessarily require the payment of the compensation of these officers out of public funds." (26 B. T. A. 1167, at p. 1171.)

Our view is supported by the decision of the Circuit Court of Appeals for the Fifth Circuit in *Therrell* v. *Commissioner*, 88 F. (2d) 869, now pending in this court, and by the recent decision of this court in *New York ex rel Rogers* v. *Graves*, 299 U. S. 401. In the latter case although the funds used to pay the employee's salary did not come from federal taxes but from the revenues of the Panama Railroad, a federal instrumentality, this court, without even commenting upon the source of the funds, held that the compensation was exempt from state taxation.

We submit therefore that the fundamental question which this court must consider in the *Freedman* case, particularly in view of its opinions in the *Brush* case, is the question of the nature and character of Freedman's employment. If it should be held that he is in the exercise of a peculiarly governmental function, then, in view of the authorities, the

source of his compensation should not affect the result, because the taxation of his compensation would be an unconstitutional interference with the power of the state in the discharge of its governmental activities.

Respectfully submitted,

HERBERT POPE,
Amicus Curiae.

Chicago, December 10, 1937.

We hereby consent to the filing of the foregoing brief.

.....,
Counsel for Petitioner.

.....,
Counsel for Respondent.

SUPREME COURT OF THE UNITED STATES.

Nos. 128, 129, 287, 597.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 128 *vs.* John H. Therrell, also known as J. H. Therrell. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 129 *vs.* William H. Tunnicliffe.	Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.
Edward McLoughlin, Petitioner, 287 *vs.* Commissioner of Internal Revenue.	Certiorari to the United States Circuit Court of Appeals for the Second Circuit.
Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 597 *vs.* Clarence H. Freedman.	Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[February 28, 1938.]

Mr. Justice McReynolds delivered the opinion of the Court.

Has the Federal Government power to tax compensation paid to attorneys and others out of corporate assets for necessary services rendered about the liquidation of an insolvent corporation by a state officer proceeding as required by her statutes?

The opinions below state the essential facts—not in dispute; make adequate references to the relevant statutory provisions; and cite numerous authorities.

No. 128.

Under Florida statutes when a bank becomes insolvent "The State Comptroller may appoint a liquidator [subject to dismissal] to take charge of the assets and affairs of such bank . . .

[who,] under the direction and supervision of the Comptroller, shall take possession of the books and records and assets of every description . . . and in his name shall sue for and collect all debts and claims belonging to it, and upon the order of the court of competent jurisdiction may sell or compound all bad or doubtful debts and on like order may sell all real and personal property . . . and sue for and enforce the individual liability of the stockholders." He shall "pay all money received by him to the State Treasurer to be held as a special deposit . . . shall make quarterly reports, or when called upon, to the Comptroller." The appointment must follow notice and be confirmed by the Circuit Court. Liquidation expenses are payable out of the corporate funds held by the Treasurer. "The compensation of the liquidator shall be fixed by the Comptroller and shall be based upon the amount of work actually and necessarily performed, and shall in no case exceed five per cent of the cash collected."

Respondent Therrell, liquidator for several banks, devoted substantially all his time to the work. He held no commission from the Governor, took no oath of office but was formally appointed by the Comptroller and gave bond. His compensation, for 1931 and 1932, paid from corporate assets, was assessed by the Commissioner for federal income taxes. The Board of Tax Appeals approved; but the Circuit Court of Appeals found immunity under the Federal Constitution.

No. 129.

Respondent Tunnicliffe, liquidator of insolvent banks appointed by the Comptroller of Florida, was assessed for federal income taxes upon the sums received for services during 1931 and 1932. The Board of Tax Appeals approved; the Circuit Court of Appeals ruled otherwise upon its opinion in No. 128. Both causes present the same points.

No. 287.

Petitioner McLoughlin was employed by the Insurance Department of New York as legal counsel in the Liquidation Bureau and received for services during 1932, $5,125.00. This bureau is in charge of a Deputy Superintendent of Insurance a civil service employe whose salary is paid by the State. It employs many persons—superintendents, attorneys, bookkeepers, stenographers, adjusters, accountants, etc.

Under the statutes the Superintendent may apply to the court for an order to take over the assets of an insolvent insurance company and liquidate its affairs. When this issues the corporate charter is dissolved and the Superintendent must proceed to collect assets, adjust claims, etc. He determined petitioner's compensation and caused it to be paid from assets of the several companies in liquidation according to the time devoted to each.

The Commissioner assessed this compensation for federal income tax; the Board of Tax Appeals approved. The Circuit Court of Appeals affirmed, and definitely held it was not exempted by the Federal Constitution.

No. 597.

Freedman, employed as an attorney in Pennsylvania's Department of Justice, received annual salary of $3,000.00. The Attorney General has power to appoint attorneys to represent any department, board or commission of the State and fix their compensation. The Secretary of Banking has broad powers over banks. When one becomes unsound he may, after notice and hearing and with the Attorney General's consent, take possession and wind up its affairs. All necessary expenses, including compensation of attorneys, special deputies, assistants and others employed about the proceedings, are paid from funds of the corporation.

During 1932 the respondent was assigned for legal work relating to closed banks and was paid by the Secretary of Banking out of their funds. The Commissioner assessed the sum so received for federal income tax. The Board of Tax Appeals approved; the Circuit Court of Appeals declared the salary exempt.

What limitations does the Federal Constitution impose upon the United States in respect of taxing instrumentalities and agencies employed by a State and, conversely, how far does it inhibit the States from taxing instrumentalities and agencies utilized by the United States, are questions often considered here. *McCulloch* v. *Maryland* (1819), 4 Wheat. 316; *Weston* v. *City of Charleston* (1829), 2 Pet. 449; *Dobbins* v. *The Commissioners of Erie*, 16 Pet. 435; *Lane County* v. *Oregon*, 7 Wall. 71; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 556; *South Carolina* v. *United States*, 199 U. S. 437, 457; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; *Indian Motocycle Co.* v. *United States*, 283 U. S. 570; *Burnet* v. *Jergins Trust*, 288 U. S. 508, 516; *Ohio* v. *Helvering*, 292 U. S. 360, 368; *Helvering* v.

Powers, 293 U. S. 214; *Rogers* v. *Graves,* 299 U. S. 401; *Brush* v. *Commissioner,* 300 U. S. 352.

The Constitution contemplates a national government free to use its delegated powers; also state governments capable of exercising their essential reserved powers; both operate within the same territorial limits; consequently the Constitution itself, either by word or necessary inference, makes adequate provision for preventing conflict between them.

Among the inferences which derive necessarily from the Constitution are these: No State may tax appropriate means which the United States may employ for exercising their delegated powers; the United States may not tax instrumentalities which a State may employ in the discharge of her essential governmental duties—that is those duties which the framers intended each member of the Union would assume in order adequately to function under the form of government guaranteed by the Constitution.

By definition precisely to delimit "delegated powers" or "essential governmental duties" is not possible. Controversies involving these terms must be decided as they arise, upon consideration of all the relevant circumstances. Notwithstanding discordant views which have sometimes arisen because of varying emphasis given to one or another of such circumstances, it is now settled doctrine that the inferred exemption from federal taxation does not extend to every instrumentality which a State may see fit to employ. Exemption depends upon the nature of the undertaking; it is cabined by the reason which underlies the inference.

Veazie Bank v. *Fenno, supra,* sustained a tax laid by the Federal Government upon notes issued by state banks, notwithstanding the view entertained by two Justices that it amounted to "taxation of the powers and faculties of the state governments, which are essential to their sovereignty, and to the efficient and independent management and administration of their internal affairs."

South Carolina v. *United States, supra,* gave occasion for much consideration of the Federal Government's power to tax instrumentalities utilized by a State. It ruled, against a stout dissent, that although South Carolina had the right to control the sale of liquors through the dispensary system nevertheless Congress could tax the dispensers who acted as agents of the State in making sales. "Looking, therefore, at the Constitution in the light of the conditions surrounding at the time of its adoption, it is obvious that the framers in granting full power over license taxes to the National

Government meant that that power should be complete, and never thought that the States by extending their functions could practically destroy it."

Burnet v. *Jergins Trust, supra,* upheld a federal tax upon the receipts by the lessee of oil lands which belonged to the City of Long Beach, California. "The subject of the tax is so remote from any governmental function as to render the effect of the exaction inconsiderable as respects the activities of the city."

In *Ohio* v. *Helvering, supra,* we held that the agencies and operations of the State of Ohio in the conduct of its Department of Liquor Control were subject to excise taxes prescribed by Congress. "Whenever a State engages in a business of a private nature it exercises non-governmental functions and the business, though conducted by the State, is not immune from the exercise of the power of taxation which the Constitution vests in the Congress."

Helvering v. *Powers, supra,* ruled that the compensation of members of the Board of Trustees of the Boston Elevated Railway Company was subject to the federal income tax notwithstanding they were appointed by the Governor of the State, confirmed by the Council, and endowed with large powers to regulate and fix fares, etc. "The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity."

The cases last referred to strikingly illustrate the outcome of efforts here to apply the recognized doctrine in respect of taxing State agencies. According to them and others of like nature due weight, we are unable to conclude that the Commissioner erred in making any one of the assessments involved in the four cases presently before us. He gave proper application to the rule which we must recognize as established. The compensation of the taxpayers was paid from corporate assets—not from funds belonging to the State. No one of them was an officer of the State in the strict sense of that term. The business about which they were employed was not one utilized by the State in the discharge of her essential governmental duties. The corporations in liquidation were private enterprises; their funds were the property of private individuals.

It follows that the judgments in Nos. 128, 129 and 597 must be reversed; the judgment in No. 287 must be affirmed.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration or decision of this case.